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THE CONCEPT OF LEGITIMACY ON INTERNATIONAL INVESTMENT  
DISPUTES: CONSTRUCTING SOUTH AMERICAN COMMON PRINCIPLES

Coordinator: Prof. LORENZO PICOTTI

Tutor: Prof. MATTEO ORTINO  
Prof. ENRICO MILANO

JOSE GUSTAVO PRIETO MUNOZ

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*THE CONCEPT OF LEGITIMACY ON INTERNATIONAL INVESTMENT DISPUTES: CONSTRUCTING SOUTH AMERICAN COMMON PRINCIPLES*

Jose Gustavo Prieto Muñoz  
PhD thesis  
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*To my parents, Washington and Elminia,  
to my wife, Alina, and kids, Alek and Alenka,  
to Juan, Diana, Matías and Martín,  
for their unconditional support.*

*These academic endeavors would be meaningless without them*

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## Summary

Con il presente elaborato si vuole sostenere tesi per cui l'inserimento di una serie di principi di diritto pubblico regionale può condurre ad una riforma interna (sistemica) del regime degli investimenti internazionali, al fine di legittimare l'autorità esercitata nello spazio giuridico globale dai tribunali degli investimenti in Sud America. Al fine di sviluppare tali principi, è necessario collocarli all'interno di un discorso giuridico regionale. Questa tesi è presentata in primo luogo attraverso una comprensione ad ampio spettro del concetto di legittimità nel diritto internazionale in generale, e nell'ambito del diritto degli investimenti internazionali in particolare; si sostiene che la legittimità operi come un concetto che descrive la spinta a conformarsi alla norma giuridica, ma che essa possa anche agire come un velo sotto il quale si cela la lotta tra le diverse autorità che popolano lo spazio giuridico globale. In secondo luogo, si scompone il regime degli investimenti internazionali in due dimensioni. La prima, quella normativa, facendo riferimento alla rete di accordi di investimento internazionali; la seconda, quella transnazionale, analizzando la giurisprudenza arbitrale che ha de facto plasmato la disciplina a livello globale. In terzo luogo, il lavoro propone un quadro generale per lo sviluppo dei principi in materia di investimenti internazionali nel contesto sud americano. Si sostiene in particolare che la regione debba ridisegnare il proprio approccio al tema, a partire da un discorso giuridico basato su tre gruppi di principi, al fine di consolidare la legittimazione dell'autorità esercitata dagli attori transnazionali.

**Parole chiave:** legittimità, pluralismo globale, diritto degli investimenti internazionali, America del Sud, America Latina.

## **Abstract**

The central argument expressed here is that it is possible to internally (systemically) reform the international investment regime and legitimize the authority exercised in the global legal space by investment adjudicators in South America, through the insertion of a set of regional public law principles and encouraging the development of these principles through regional legal discourse. This argument is presented first with a general understanding of legitimacy in international law. Then it takes on the task of developing a concept of legitimacy for international investment law, arguing that legitimacy operates as a concept which describes the pull of self-compliance of a legal order, but can also act as a veil that covers up the struggles of various authorities in the global legal space. The argument further decomposes the international investment regime into two dimensions. The first, the normative dimension, refers to the network of International Investment Agreements, while the second, the transnational dimension, involves the study of that fragment of global society that has shaped the discipline by building arbitral jurisprudence. Finally, the current work develops a basic framework for the construction of South American principles for investment. It will be argued that the region must reshape its approach to some extent, by using a legal discourse based on three clusters of principles for the legitimation of authority.

**Keywords:** Legitimacy, global pluralism, international investment law, South America, Latin America.

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## ***1. Introduction: Why Legitimacy Matters In International Investment Law***

### ***1.1 Motivation, Problem and Research Questions***

October 6, 2012 was a day that shocked Ecuadorian society. An international arbitral tribunal ordered the South American country to pay nearly 1.77 billion US Dollars to the multinational oil company ‘Occidental’<sup>1</sup> at the end of a very controversial investment dispute that lasted six years. The order was rejected by the Ecuadorian government and various social groups, not only because the idea of paying an indemnification to a foreign oil company in South America was not popular *per se*, but also because the amount was equivalent to the Ecuadorian health care or education budgets of that year. It was believed that payment would alter the national budget plan in subsequent years. The situation forced Ecuador to initiate an annulment proceeding to set aside the award under the ICSID rules, a process that came to an end on 2nd November, 2015, when an Ad-Hoc Annulment Committee partially annulled the award and reduced the amount due to \$ 1,06 billion USD, but only due to an error in the calculation of damages rather than for substantive<sup>2</sup> reasons.

This case drew attention from outside Ecuador as well because it involved one of the largest amounts of money ever granted to any investor in the recorded history of investment arbitration<sup>3</sup>, and one of the largest payments ever ordered by an international adjudicator. It sparked a public debate in which critical voices arose

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<sup>1</sup> *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador (ICSID Case No ARB/06/11)*, 2012).

<sup>2</sup> The partial annulment decision was taken on the grounds that the Tribunal assumed jurisdiction with regard to the investment now beneficially owned by other investors.

<sup>3</sup> This amount would later be greatly surpassed by a set of awards comprised in the *Yukos v Russia* awards in 2014 which totalled more than 50 billion USD. However, this series of awards was set aside [or ‘overturned’?] by a district court in The Hague, Netherlands, and continued to be litigated within the domestic system of this country. For a reference regarding the amounts of money granted to investors in investment arbitration by the time the award was issued see UNCTAD United Nations Conference On Trade And Development, "IIA 2013, Issue Note No 3: Reform of Investor-State Dispute Settlement: In Search of a Roadmap", 2013, 1.

and questioned the legitimacy of the system as a whole<sup>4</sup> and whether it made sense for Latin American countries to continue to participate in it. In this respect, the Occidental case was not only relevant to South America<sup>5</sup>, but also to other controversial cases around the world including the *Philip Morris vs. Australia* and *Uruguay*<sup>6</sup> and the two *Vattenfall* cases against Germany.<sup>7</sup> These disputes have drawn multidisciplinary attention, not only from lawyers, but also from political scientists and economic scholars interested in the field of international investment law<sup>8</sup> and debates about its effectiveness and legitimacy<sup>9</sup>.

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<sup>4</sup> For a critical view of the system see also: René Urueña, "You'd Better Listen: Notes on the Mainstreaming of Public Participation in Foreign Investment Arbitration", (2010) 16 *Int. Law: Rev. Universidad de los Andes*, Nicolás Perrone, "Los Tratados Bilaterales de Inversion y el Arbitraje Internacional: ¿En Dirección al Mejor Funcionamiento De Las Instituciones Domesticas?", (2012) 17 *FORO - Universidad Andina Simón Bolívar*.

<sup>5</sup> More recently, the 22 of August 22, 2016 The ICSID Arbitration Tribunal of *Rusoro Mining Limited v The Bolivarian Republic of Venezuela*, ICSID Case No. ARB(AF)/12/52016. Rusoro against the Bolivarian Republic of Venezuela awarded the Canadian Company damages plus pre- and post- award interest in excess of US\$1.2 billion. See info available on the website of the company <[http://www.rusoro.com/s/News\\_Releases.asp?ReportID=761079](http://www.rusoro.com/s/News_Releases.asp?ReportID=761079), accessed 24 August 2016.

<sup>6</sup> The states of Uruguay and Australia decided to issue black packaging legislation with the aim of preventing their citizens from smoking. This originated separate investment arbitration processes by the Tobacco company Philip Morris, which argued that such legislation affected their principal asset, their trademarks.

<sup>7</sup> The Swedish company Vattenfall has initiated two separate arbitration proceedings against the state of Germany to ease environmental standards that were issued in 2009 and that were perceived to be contrary to the investment. The second Vattenfall in 2012 contests the decision of Germany to phase out its nuclear energy program, which was also seen as detrimental to investor rights. Both cases are confidential. (a) *Vattenfall Ab and Others v Federal Republic of Germany*, (ICSID Case No ABR/12/12 2009). (b) Formerly, *Vattenfall Ab, Vattenfall Europe Ag, Vattenfall Europe Generation Ag & Co. Kg v The Federal Republic of Germany* (ICSID Case No ARB/09/6).

<sup>8</sup> See UNCTAD UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT, "IIA 2013, Issue Note No 3: Reform of Investor-State Dispute Settlement: In Search of a Roadmap" (2013).

<sup>9</sup> S. D. Franck, 'The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions', (2005) 73 *Fordham Law Review*.

In recent years, there have been two ways societies could respond to cases coming from the international investment law regime: either by leaving the regime or by transforming it. The first response, leaving the regime, consists in the restoration of an old conception of sovereignty in which the state is the *sovereign* entity that exercises an absolute and supreme authority over its territory. There are two legal strategies possible within this response. The first strategy is “unplugging” a country from the regime: denouncing all of the investment treaties that bind a state to that investment regime<sup>10</sup>. The second strategy is the use of internal public law, particularly in the constitutional sphere, to “protect” the country from interference by the investment regime or to prevent future governments in the same country from granting consent to arbitration of investment<sup>11</sup>.

The attempt to revive the concept of absolute sovereignty, through either one of these two strategies, has a fundamental conceptual problem that can be described as a methodological boomerang for Latin American society. This is because restoring the supreme and exclusive authority of the State directly affects important features of other regional systems that depend on a conception of permeable authority that can co-exist with others at the global level, such as the Inter-American Human Rights System. As a result, the same states that initially tried to leave the investment regime<sup>12</sup> have subsequently questioned the authority of the inter-American system.

Additionally, International Investment Agreements have a complex system of provisions governing any unilateral termination which serves to defend the stability<sup>13</sup> of the regime. Consequently, leaving the investment regime can not be

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<sup>10</sup> In the case of the Latin American region, this was the path taken by Ecuador, Venezuela and Bolivia.

<sup>11</sup> See: art 422 (Constitución de la República del Ecuador) and art 366 (Constitución Política del Estado Plurinacional de Bolivia)

<sup>12</sup> Gonzalo Rodríguez Carpio, *La Denuncia del Convenio CIADI Efectos y Soluciones Jurídicas* (Editorial Jurídica Venezolana 2014) 12-17.

<sup>13</sup> Two types of clauses in treaties: the periods of validity and survival of obligations. The clause validity period usually includes a time before which the treaty cannot be terminated unilaterally, i.e. if a state decides to denounce a treaty, a minimum number of years stipulated in the treaty itself must have already elapsed. The second important provision is the survival of obligations, which sets the

achieved as a single act but requires a slow and gradual process that can take up to 20 years.

Using domestic law as a means to leave the regime has not worked for states when the neighbors of that state do not follow the same path of disassociation . On the contrary, in such a scenario, the state that tries to leave the investment regime puts itself at a competitive disadvantage, since all states in the region are competing to attract flows of capital.

The second response, one which can be utilized when there is greater consensus, is to reform the current investment regime without abolishing it. In this scenario, the international investment law is considered to enter an era of ‘re-orientation’<sup>14</sup> in which there is no doubt about the need to reform the global investment regime but only about the method, content and extent of this reform <sup>15</sup>.

At the multilateral level, much of this kind of reform has taken place within the framework of the United Nations Conference on Trade and Development (UNCTAD), where a new generation of investment treaties have been studied along with new core principles<sup>16</sup> to offer states the ability to individually adopt a wide variety of options in their investment treaties<sup>17</sup>, as well as at the domestic level.

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time that a treaty continues to have effects on investments already established within a state. The terms of survival periods vary per treaty, ranging from 5 to 25 years

<sup>14</sup> UNCTAD, ‘Taking Stock of IIA Reform. March 2016’ (UNCTAD IIA Issues Note 2016), <[http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d1_en.pdf)> accessed 3 March 2016.

<sup>15</sup> UNCTAD, ‘Taking Stock of IIA Reform. March 2016’ (UNCTAD IIA Issues Note 2016), <[http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d1\\_en.pdf](http://unctad.org/en/PublicationsLibrary/webdiaepcb2016d1_en.pdf)> accessed 3 March 2016.

<sup>16</sup> "Investment Policy Framework for Sustainable Development", UNCTAD, 2015.

<sup>17</sup> UNCTAD, Investment Policy Framework for Sustainable Development, 2015 <[http://unctad.org/en/PublicationsLibrary/diaepcb2015d5\\_en.pdf](http://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf)> accessed 25 March 2016, UNCTAD, ‘WIR 15 Reforming the International Investment Regime. An Action Menu. Chapter IV’ (UNCTAD Word Investment Report 2015) <[http://unctad.org/en/PublicationChapters/wir2015ch4\\_en.pdf](http://unctad.org/en/PublicationChapters/wir2015ch4_en.pdf)> accessed 25 March 2016.

UNCTAD, ‘World Investment Report 2015’ (UNCTAD Word Investment Report series 2010 – 2015) <[http://unctad.org/en/PublicationsLibrary/wir2015\\_en.pdf](http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf)> accessed 24 March 2016. See further UNCTAD Investment, Enterprise and Development Commission hosted in Geneva, Switzerland which includes two Expert Meetings, one entitled ‘on the Transformation of the

This reform includes five broad paths: promoting alternative dispute resolution, tailoring the existing system through individual IIAs, limiting investor access to ISDS, introducing an appeals facility and creating a standing international investment court<sup>18</sup>.

Furthermore, at the regional level there are an increasing number of dispute resolution bodies, with the dominant trend being the creation of permanent adjudication bodies. An example is the Investment Court System used for new treaties in the European Union since the Treaty of Lisbon had included exclusive competence in foreign direct investment as part of its common commercial policy<sup>19</sup>. Nowadays, only Canada (CETA agreement) and Vietnam have accepted the European proposal. The United States and Europe are currently negotiating the Transatlantic Partnership on Trade and Investment (TTIP by its acronym in English), which if ratified, will certainly have a global influence on methods of dispute resolution.

Within the second response, that is, reforming the regime, either by following any of the paths drawn by UNCTAD or by creating multiple bilateral investment courts, still requires that the element of time be taken into consideration. Any reform of the regime will require a long period of time, since states have to wait either for a treaty to be renewed or for a massive renegotiation of treaties, in itself a major challenge for any developing country.

The external scenarios of reaction to the international investment law regime indicate that, at least for the next few years, Latin American states will remain involved in arbitration processes arising from treaties signed during the 1990s, until new disputes, based on more normative 'developing friendly' treaties, become the rule. Therefore, we need to think about a third scenario that brings together the

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International Investment Agreement Regime: The Path Ahead' from 25-27 February 2015, and the second 'Taking Stock of IIA Reform' from 16-17 March 2016.

<sup>18</sup> United Nations Conference On Trade And Development.

<sup>19</sup> Catharine Titi, "The European Union's Proposal for an International Investment Court: Significance, Innovations and Challenges Ahead" (2016) *TDM*, [www.transnational-dispute-management.com](http://www.transnational-dispute-management.com).

various positions that demonstrate more concern for an internal transformation of the regime.

New trends in the doctrine have emerged in this sense, creating a third scenario of reaction to the international investment regime, where there is either tacit or expressed concern about the quality and legitimacy<sup>20</sup> of the system from an internal perspective and about developing jurisprudence specifically for the international investment regime. Within the scope of these aims, any intended change implies taking into account not only the normative dimensions of treaties, but also operating within the transnational community that shapes investment arbitration.

In this scenario, South America is one of the regions that can help to better understand how legitimacy operates within the international investment law regime for two reasons. First, because the decisions enacted by arbitral tribunals have been a topic for public debate for several years, and these debates have gone beyond analysis by specialized practitioners and scholars, have crossed disciplinary boundaries and have even been included in people's everyday conversation. In some countries, such as Ecuador and Bolivia, decisions made by arbitral tribunals have been debated by the constitutional assemblies of new constitutions. The second reason relates to the activity in various South American nations with respect to conflicts derived from arbitration proceedings under the current international investment regime. Of the more than 700 known investment cases around the world, more than 200 involve a Latin American State; 150 of which can be linked to South America.

Therefore, discussing the legitimacy of the investment regime as a whole involves a precise discussion of the moral and sociological justification for an exercise of public authority by arbitrators and the capacity of substantive rules within the system to generate voluntary compliance with its implementation in Latin American societies. This is precisely one of the advantages offered by this conceptualization, since it is not necessary to wait for the normative dimension of the regime to be changed.

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<sup>20</sup> Franck (n 9).

Finally, looking for a systemic internal transformation of the international investment regime from within, beyond the two scenarios described above (i.e. leaving the regime or transforming it from the outside), allows new questions to rise: How can international investment law achieve legitimacy? Should legitimacy be pursued differently in the regional context, and if so, how would this differ from the legitimacy of the exercise of power of investment arbitrators in the South American region?

These questions should fall within the scope of legal scholarship, since the study of any legal system must include an assessment of the effectiveness and legitimacy of the principles and rules within the society that applies them.

## ***1.2 Structure of the Thesis***

In order to answer the aforementioned set of questions, the following argument will be developed throughout this thesis: It is possible to internally (systemically) reform the international investment regime and legitimize the authority exercised in the global legal space by investment adjudicators in South America, through the insertion of a set of regional public law principles. Further, a regional legal discourse for the region is required to develop these principles.

First, however, we must verify the premises at the basis of this argument. Most importantly, we need to first establish that investment arbitrators within the current network of more than 3,200 investment agreements are not only solving the disputes brought forward by the parties, but are indeed exercising a particular type of public authority outside the state. If arbitrators exercise this type of authority, the consequence is that the consent of the state to arbitration is not enough to legitimize the authority of a tribunal, as happens with commercial arbitration.

In adopting these central premises, there is also a need to review the methodology used to understand the international investment regime. The classic approach originally used a definition of international economic law as ‘rules of public international law which directly concern economic exchanges between subjects of international law.’<sup>21</sup> Under this conception, it is possible to see only the normative dimension of the international investment regime; however, a closer look

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<sup>21</sup> Ignaz Seidl-Hohenveldern, *International Economic Law* (Nijhoff, 1989) 1.



at the discipline indicates that there is also a transnational dimension composed of an epistemic community that has had a role in shaping its conceptual repertoire. This dynamic can be better understood from pluralistic accounts of law outside the state, usually grouped under the label of global legal pluralism, that acknowledge the existence of global sectors of society that develop different criteria for the validity of norms alongside those developed within states.

The argument will be presented in the following way. First, a general understanding of legitimacy in international law needs to be provided. Studies have struggled with the concept of legitimacy, since it has been used in many different contexts with different meanings. Chapter 2 takes on the task of providing a concept of legitimacy for international investment law, arguing that legitimacy operates as a concept which describes the pull of self-compliance – as explained in terms of the legal, moral, or sociological grounds for law or acts of authority – but can also act as a veil that covers up the struggles of several authorities in the global legal space.

Second, we need to reassess international investment law discipline and its system of arbitration from the conceptual standpoint of global legal pluralism. Chapter 3 decomposes the international investment regime into two dimensions. The first, the normative dimension, refers to the network of International Investment Agreements first signed in 1959 by European countries but which later extended as a practice to the rest of the world. The second, the transnational dimension, involves the study of that fragment of global society, or those communities, that have shaped the discipline of international investment law in parallel with the evolution of treaties, i.e. it explores the dynamics that work towards building an arbitral jurisprudence.

Finally, in Chapter 4, the findings of previous chapters are used to develop a basic framework for the construction of South American principles for investment. This chapter provides a historical analysis of the most important conceptual trajectory for dealing with foreign investment in the region, the Calvo doctrine, and explains how it has re-emerged in some South American countries. It will be argued that the region must reshape its approach to some extent, by using a legal discourse based on three clusters of principles for the legitimation of authority.

## ***2. Removing the Veil of ‘Legitimacy’ from International Investment Law Discourse***

Legitimacy is synonymous with self-compliance or obedience to the commands or dispositions of a normative order, based on any grounds other than fear of sanctions. The concept is not a new one and has been present in philosophical discussions of law for centuries.

However, the word legitimacy was used in international legal debates at the end of the 20<sup>th</sup> century, and later in International Investment Law at the beginning of the 21<sup>st</sup> century, to veil the sectorial social struggles taking place between overlapping transnational communities in a globalizing society. These struggles of authority represented a break from the conceptual scope of International Law as it had been conceived in Emer de Vattel’s works in the early years of the discipline.

In this context, the following chapter advances a simple yet straightforward argument: Legitimacy in International Investment Law is a linguistic label that functions as a veil for the claims put forward by investment arbitrators and their resistance to a type of *sectorial relative public authority*. Once we remove this veil of ‘legitimacy’, we can more realistically assess the validity of the relevant rules and the extent to which this type of public authority can be justified.

The current chapter seeks to remove this veil. First, by providing a concept of legitimacy in general and by further decomposing this notion into three constituting concepts: validity (legal legitimacy), obedience (sociological legitimacy) and justifiability (moral legitimacy). Second, by following the conceptual construction of these ideas in the development of international law, to take on the status of a “second order observer”. Specifically, we follow the trajectory of the Vattelian arrangement in international law, still present today, to explain how departures from these arrangements by new forms of public authority outside the level of the state can generate tensions. Third, by adopting a form of global pluralism as a method to process challenges in international investment law.

Finally, by explaining that a discursive approach to principles represents a conceptual alternative for South American nations.

### ***2.1 The Concept(s) of Legitimacy***

Legitimacy is a word used in so many contexts that it can hardly be seen as a singular concept. Often this term is used without specific meaning, simply to discredit an opinion or judgment; therefore, a claim of illegitimacy can also be an act of resistance to someone else's authority. For this reason, it is necessary to specify the context and specific reference of this term in any type of legal argument.

The concept has been brought to the attention of both scholars in international law, who are mostly concerned with the legitimacy of rules, and academics in International Relations who mainly focus on the legitimacy of the exercise of power by either leaders or institutions. These two types of concerns about legitimacy—authority and rules—are connected because it is difficult to separate authority from the rule itself: most often authority comes from a rule, while the exercise of authority can also generate new rules, as in the case of judicial decision making.

Regarding the legitimacy of rules, one of the clearest conceptions comes from the work of Thomas Franck, who defines legitimacy as 'the capacity of a rule to pull those to whom it is addressed towards consensual compliance'<sup>22</sup>. On the other hand, the legitimacy of institutions has been defined as the 'right to exercise authority—right to rule'<sup>23</sup>, or as a justification of 'the exercise of public authority'<sup>24</sup>. In this sense, as Franck has also acknowledged, the notion of

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<sup>22</sup> Thomas M. Franck, "The Power of Legitimacy and the Legitimacy of Power: International Law in an Age of Power Disequilibrium" (2006) 100 *The American Journal of International Law* 93.

<sup>23</sup> Daniel Bodansky, "Legitimacy: concepts and conceptions/normative and descriptive" in Jeffrey L. Dunoff, *Interdisciplinary Perspectives on International Law and International Relations the State of the Art* (Cambridge Univ. Press 2013) 324; See also John Tasioulas, *Parochialism and the Legitimacy of International law* in Mortimer N. S. Sellers, *Parochialism, Cosmopolitanism and the Foundations of International Law* (Cambridge Univ. Press 2012) 17.

<sup>24</sup> Rüdiger Wolfrum, "Legitimacy in International Law", *Max Planck Encyclopedia of Public International Law* 2011) para 1.

legitimacy is not the sole factor that explains why actors (individuals or states) obey the law, but it proves helpful in understanding how normative systems become binding.

If these two conceptions are connected, it is possible to form a general understanding of the concept of legitimacy as:

*Capacity— of normative orders and acts in the exercise of authority—to generate voluntary compliance from those who are addressed for reasons beyond the use of force or coercion.*

This definition makes it possible to see legitimacy as a sort of force generated by normative orders, gravitating towards self-compliance. In addition, it refines the conceptual nature of what is ‘law’ moving beyond the simple explanation offered by early positivist conceptual accounts of law as rules enforced through coercion.<sup>25</sup>

Understanding normative orders as a system of rules that are applied with the use of force, does not allow us to distinguish legal rules from ‘commands of outlaws’, as H.L. Hart pointed out in his refined positivist version.<sup>26</sup> For this reason, when a rule or an institution is believed to be legitimate, it is followed for reasons other than fear or coercion.

However, this definition is only a starting point, considering that a universe of assumptions exists to explain the roots of the capacity to pull participants towards consensual compliance, and how this capacity can be evaluated. Understanding

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<sup>25</sup> See especially the understanding as: “rule laid down for the guidance of an intelligent being by an intelligent being having power over him” in John Austin and Wilfrid E. Rumble, *The Province of Jurisprudence Determined* (Cambridge University Press 2001) 18.

<sup>26</sup> In the development of his theory, H.L. Hart was troubled by the idea that coercion can define the nature of a norm as ‘legal’. In that case, the mere command of a gunman to an unarmed man cannot be distinguished from law. Even though the ideas expressed in his book ‘The Concept of Law’ have been subject to a lot of criticism in the last decades, this idea is still useful in the discussion of Legitimacy without coercion according to the core concept of bindingness. On this point see Herbert L. A. Hart and Penelope A. Bulloch, *The Concept of Law* (Oxford Univ. Press 1994) 82-84.

legitimacy is a methodological issue —understood as an applied theory<sup>27</sup> —because it takes the analysis into the deepest conceptual assumptions of each observer. For this reason, when the issue of legitimacy arises in a legal debate it may involve diverse ideas. In order to systematize the wide variety of assumptions, we need a framework of analysis that can help us distinguish between the concepts of ‘legitimacy’ used in various theoretical arguments.

In this sense, one of the clearest efforts to systematize the debate surrounding the word ‘legitimacy’ is found in the work of Richard H. Fallon.<sup>28</sup> He identified three standards, or criteria, used to discuss legitimacy in the context of judicial decision making on constitutional law. These criteria in turn, produce different categories of legitimacy that are contained or implied in a debate: (i) legal, (ii) sociological and (iii) moral.

### 2.1.1 Legitimacy as a Legal Concept

The first category, *legal*, is based on the assumption: that “*which is lawful is also legitimate*”<sup>29</sup>. Here, the idea of legitimacy is equivalent to validity. As such, a norm should be followed because it has fulfilled the criteria of validity in every system. Most of the discussions about these criteria of legitimacy are therefore closely aligned to the standpoint of legal positivism. In other words, debates about the concept of legal legitimacy are in turn debates about the sources of law.

The legal criteria, according to Fallon, comprises two sub-categories. On the one hand, ‘substantive legal legitimacy’<sup>30</sup> is understood as the correctness or

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<sup>27</sup> We adopt the definition of method as discussed by Anne-Marie Slaughter and Steven R. Ratner, "The Method Is the Message" (1999) 93 *The American Journal of International Law* 410. Other nomenclatures used in the doctrine refer to conceptual assumptions as: ‘approach’, (see Anne Peters, "There Is Nothing More Practical than a Good Theory an Overview of Contemporary Approaches to International Law" (2001) 44 *German Yearbook of International Law*) and ‘methodology’, see Robert Cryer, Tamara Hervey, and Bal Sokhi-Bulley, *Research Methodologies in Eu and International Law* (Hart 2011).

<sup>28</sup> See Richard H. Fallon, Jr, "Legitimacy and the Constitution" (2005) 118 *Harvard Law Review*. (Thank you to Abdul Salim Amin for pointing me towards the work of Fallon, and for discussing the application of this framework to his own work on the Afghanistan Constitutional Reform).

<sup>29</sup> *ibid* 1794.

<sup>30</sup> *ibid*.

reasonableness of a ruling as a matter of law. Therefore, this criterion focuses on understanding if a particular decision is based on valid law. On the other hand, there is the concept of ‘authoritative legitimacy’<sup>31</sup> when the authority that enacts a decision is perceived to be legitimate, meaning that it has the right to determine rules within a system regardless of the legality of the decision. In this case, the debate over legitimacy will be equivalent to casting doubts on the jurisdiction of an adjudicator.

For example, if adjudicator A makes a decision about the legal situation of subject B, and B challenges the legitimacy of this decision, B’s argument will make use of *the* substantive *legal* criterion if the label illegitimacy/legitimacy is used to replace the idea of illegality/legality. In other words, claims that fall into the ‘substantive legal criteria’ are focused on the legality of an act, including its conformity with a superior norm, such as the constitution of a national system, or foundational treaties in the case of an integration process.

On the other hand, a claim that falls under the criterion of ‘authoritative legitimacy’ means the authority that has enacted a particular decision or ruling does not have ‘the right to rule’ regardless of the correctness of the decision. In the example provided, this is the case if B has built an argument around the powers of the adjudicator A, and labels his claim using the legitimacy/illegitimacy wording.

In the legal criterion, the capacity to pull someone towards self-compliance lies in the recognition of a rule as law. In addition, the interaction of these two sub-categories (authoritative and substantial) opens the space for judicial error, where judicial decision is recognized, and its decision is followed despite a perceived legal misapplication, just because the adjudicator is believed to be legitimate.

### **2.1.2 Legitimacy as a Sociological Concept**

The second criterion, or standard, is a sociological concept. Fallon describes how a regime, institution or decision possesses legitimacy when: “*a relevant public, regards it as justified, appropriate, or otherwise deserving of support for reasons beyond fear of sanctions or mere hope for personal reward*”<sup>32</sup>. If the word

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<sup>31</sup> *ibid* 1795.

<sup>32</sup> *ibid* 1795.

legitimacy is used in this context, it implies that the pull of self-compliance of a norm or an institution is rooted in a social belief in obedience.

The development of legitimacy as a sociological concept can be traced to the work of Max Weber, especially in his book *Economy and Society*<sup>33</sup>. Weber focused a part of his work on trying to understand authority, by analyzing the concepts of domination<sup>34</sup> and obedience. In his work, he attributes at least five meanings to the word legitimacy,<sup>35</sup> but central to his analysis of legitimacy as a sociological concept is an understanding of the existence of a claim authority, together with the acceptance of this claim.

This separation of elements allows him to categorize the type of legitimacy, in terms of the nature of the claim of authority<sup>36</sup>. He determines three types of authority. First, a *rational*, or legal type that is based on belief in the legality of enacted rules, and the right of those elevated to authority to issue commands. In this case, obedience is objective and detached from any person. Second, a *traditional* type that is based on belief in the “*sanctity of immemorial traditions*”, where obedience is therefore owed to a person, due to the position they represent. Finally,

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<sup>33</sup> Max Weber, *Economy and Society: An Outline of Interpretive Sociology* (University of California Press 1978).

<sup>34</sup> Weber understood domination as “*the probability that certain specific commands (or all commands) will be obeyed by a given group of persons*” and assimilated it with the idea of authority, see *ibid.*p.212

<sup>35</sup> Throughout his work, Weber used the word Legitimacy as: 1) Claim (of authority); 2) Justification of a regime; 3) As a promise of a regime, specifically analyzing the charismatic type of authority; 4) Self-justification by the fortunate; 5) As a Belief (of promises, claims justification). For a discussion of the way that the word legitimacy is used in the work of Weber, see Joseph; Bensman, *From Joseph Bensman: Essays on Modern Society* 2014 Chapter 10: Max Weber’s Concept of Legitimacy 325-371.

<sup>36</sup> He explains this separation in the following way: “*Every such system attempts to establish and to cultivate the belief in its legitimacy. But according to the kind of legitimacy that is claimed, the type of obedience, the kind of administrative staff developed to guarantee it, and the mode of exercising authority, will all differ fundamentally. (...) Hence it is useful to classify the types of domination according to the kind of claim to legitimacy typically made by each(...)*” Weber 213.

a *charismatic* type, based on devotion to the exemplary character of an individual person; obedience to this type of authority is rooted in loyalty.<sup>37</sup>

The study of authority and obedience in these categories separates the debate on legitimacy from the purely legal dimension because it helps to distinguish the concept of the validity of norms from the concept of acceptance of authority in a society. In other words, it offers an external point of view on the phenomenon of self-compliance, where the internal point of view involves a debate on the validity and sources of law.

### 2.1.3 Legitimacy as a Moral Concept

Finally, there is a third dimension and criterion: when legitimacy is treated as a moral concept. In this case, legitimacy is not only considered in terms of valid norms, or sociological explanations of compliance, but also in terms of the moral ‘justifiability’<sup>38</sup> of rules and authority. Under this conception, a rule exerts the pull to self-compliance, not merely because it is a rule, but because it is fair, thus moving the debate to philosophical considerations. When treated as a moral concept, legitimation refers to the process by which power is not only institutionalized but, more importantly, given moral grounding<sup>39</sup>. Under this concept, the term ‘legitimacy’ becomes interchangeable with ‘authority’, when such authority is considered valid.

Jurgen Habermas provides a clear definition of legitimacy as a moral concept by linking it to one of the characteristics of political orders. He states: ‘Legitimacy means that there are good arguments for a political order’s claim to be recognized as right and just; [...] Legitimacy means a political order’s worthiness to be recognized’.<sup>40</sup> Habermas further distinguishes the ‘legitimizing grounds’ from the given levels of justifications and analyzes how the need for legitimation has

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<sup>37</sup> *ibid* 215-216.

<sup>38</sup> Fallon Jr (n 28) 1796.

<sup>39</sup> Scott John and Marshall Gordon, "Legitimacy", *A Dictionary of Sociology* (Oxford University Press', 2009).

<sup>40</sup> Jürgen Habermas and Thomas McCarthy, *Communication and the Evolution of Society*, (Beacon Press, 1979) 178.



grown over time,<sup>41</sup> transitioning from the use of ‘myths of god’ in early societies to the use of the principle of reason to justify actions in modern political orders.<sup>42</sup>

The understanding surrounding the word legitimacy as a moral concept — therefore a philosophical one— also raises the problem of systematization because of the wide variety of theories that have tried to provide answers to the justifiability of rules and authorities. In order to tackle this diversity, Fallon further elaborates a distinction within this dimension of his conceptual framework by distinguishing between *ideal* and *minimal* moral theories<sup>43</sup>.

The *ideal* moral category tries to include theories that aim to determine the conditions that maximize respect for authority in a determinate society. In this moral sub-category, different types of political ideas justify the exercise of authority as based in the consent of the people, or in substantial objective principles of justice.

On the one hand, the moral consent-based ideal theories postulate that the primary source for the exercise of authority comes from the people, as is the case with the fundamentals of constitutionalism in the United States.<sup>44</sup> On the other hand, the moral ideal substance-based theories focus more on the justification of the principles themselves, under the premise that a just regime ought to be legitimate even without the consent of the people,<sup>45</sup> because this regime intrinsically possesses the values of fairness.

*Moral minimal* theories, on the other hand, study the ‘sufficient just’ conditions of legitimacy in the absence of viable alternatives<sup>46</sup>. This notion acknowledges that social interaction requires at least some minimal degree of authority and hence government. Following this argument, in case the highest

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<sup>41</sup> *ibid* 182.

<sup>42</sup> *ibid* 184.

<sup>43</sup> Fallon Jr (n 28) 1797

<sup>44</sup> Fallon refers to the principles contained in *The Federalist*. For example, the description of consent as the primary source by Alexander Hamilton in the conclusion of Federalist No 22: “*The fabric of American empire ought to rest on the solid basis of the consent of the people. The streams of national power ought to flow immediately from that pure original fountain of all legitimate authority*”. Alexander Hamilton, James Madison and John Jay, *The Federalist* (Liberty Fund Inc 2001) 112.

<sup>45</sup> Fallon Jr (n 28) 1797.

<sup>46</sup> *ibid* 1798.

standards of justice or fairness cannot be met, a minimal legitimacy is better than none. It can also be said that moral minimal theories are based on the ideal of civilized coexistence within a society.

There are clear differences between discussions of legitimacy as a moral (either minimal or ideal), or as a legal or sociological concept, even when analyzing similar events. For example, when commenting on the authority of an influential individual, a sociological account will focus on the Weberian concern for the charismatic attributes of that individual, while the same discussion of legitimacy as a moral concept will focus on the justifiability of the delegation of authority by a specific society to this particular individual<sup>47</sup>.

#### **2.1.4 Remarks on the Tridimensional Approach to Legitimacy**

The Fallon three-dimensional framework—legal, sociological, and moral— does not seek to answer these questions related to the debates surrounding the word legitimacy, but rather proves useful in terms of at least structuring them. It provides structure in two ways: first, it allows us to determine what particular interests led to the use of this word in arguments, and; second, the use of this framework allows us to build an argument or discussion using more concrete or narrowly defined concepts, mainly: validity, social acceptance, and justifiability.

First, by framing the concept of legitimacy using these categories we can determine what interest a person making a claim using this word may have. The use of legitimacy as a legal concept represents an interest in fidelity<sup>48</sup> to the law understood as respect for legal norms, and it is no surprise that a broad range of legal doctrine sees legitimacy as synonymous with legality. The use of the concept legitimacy within a sociological context presents challenges, because it can be used

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<sup>47</sup> See for example the discussion of James Madison, in the Federalist No 38: ‘It is not a little remarkable, that in every case reported by ancient history, in which government has been established with deliberation and consent, the task of framing it has not been committed to an assembly of men; but has been performed by some individual citizen, of pre-eminent wisdom and approved integrity (...) What degree of agency these reputed lawgivers might have in their respective establishments, or how far they might be clothed with the legitimate authority of the people, cannot, in every instance, be ascertained’.

<sup>48</sup> Fallon Jr (n 28) 1851.

to enhance the authoritative character of judicial or arbitral decisions, or to acknowledge the decrease of authority during crises. It is no surprise that many debates about legitimacy as a sociological concept arise during times of uncertainty such as revolutions or changes of constitutional orders. Finally, the use of legitimacy as a moral concept raises a wide variety of philosophical concerns related either to setting high goals in the architecture of a specific regime or to pressuring for reform.

The second advantage of the use of these categories is that they permit a framework for the analysis of more specific concepts that would otherwise be grouped under the same label as discussions about 'legitimacy'. For instance, the legal dimension of legitimacy focuses more on the issue of the validity of legal norms, while the sociological and moral dimensions focus more on issues related to the acceptance and justifiability of authority<sup>49</sup>.

However, the use of the three-dimensional framework also has its downsides and these ought to be acknowledged. First, it can be argued that it is not always possible to make this clear-cut division into three-dimensions of legitimacy. For instance, an argument about the legal dimension of legitimacy may underscore, in the final analysis, a moral concern regarding the primacy of principles such as democracy. The consideration of the primacy of the state as the source of valid norms in international law is, ultimately, an argument that pursues the integrity of some type of chain of legitimacy, with the state as the minimal representative of the people's will. In this way, the whole political debate on legitimate authority includes both sociological and moral dimensions. In such cases it can be said that, even though there are some points of connection between the dimensions, some aspects are more prominent in the debate.

Second, Fallon conceived this three-dimensional approach to the study of constitutional legitimacy in a very different context. He was working with the assumed premises of having a defined territory and population, along with the existence of some kind of center of power. For this reason, adopting this framework is only the first step in building an understanding of legitimacy in international law

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<sup>49</sup> Sociological legitimacy will focus more on the sources of authority, while moral legitimacy will be concerned with the justifiability of such authority.

and international investment law, where there is no center of power: neither a defined population nor a limited territory.

## ***2.2 Removing the Veil of the Word ‘Legitimacy’ from the International Law***

### ***Debate***

The debates concerning the term legitimacy in international law have become increasingly relevant over the last few decades because of the expansion —both normative and institutional— of law outside the state. A great majority of this expansion is due to increasing activity by states since the Second World War, that have either concluded a great number of treaties or created a considerable number of international organizations and adjudication bodies<sup>50</sup>. This transformation has already left behind the questions that troubled legal scholars for centuries: is international law, ‘law’? Can sovereigns be bound by agreements between them? Nowadays, the discipline has entered a ‘post-ontological’<sup>51</sup> stage where new sets of questions regarding the quality rather than the existence of international law have been on the rise, and some of these questions are related to the word ‘legitimacy’.

In this sense, over the last decades, the word ‘legitimacy’ has served as a veil that covers the complexity of the production of norms outside the nation-state, and if this veil is removed, what can be seen is a methodological gap, between the conceptual model that has held sway over the discipline of international law for centuries, and the reality of the production of normativity in the global legal arena.

In other words, the debates about legitimacy not only describe specific legal problems, but also highlight the struggle for the rise of different types of public authorities beyond the nation state, as explained below. The argument that follows in this chapter is that international investment law is a regime that has developed precisely within the borders of this methodological gap. Therefore, debates about legitimacy in this field are not only a specialized technical matter, but, on the contrary, demand an understanding of the conceptual situation of the global legal arena as a whole.

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<sup>50</sup> This transformation will be discussed in detail in Ch 2.

<sup>51</sup> Thomas M. Franck, *Fairness in International Law and Institutions* (Oxford University Press 1997) 6.

The development of this argument in the present chapter goes as follows. First, the conceptual model that explains the system of authority and justifiability in which international law was constructed, as a discipline, will be discussed. This conceptual setting, traced back to the work of Emer De Vattel (1714-1767), a Swiss diplomat and legal theorist, consists of an arrangement for the exclusive territorial type of public authority that was exercised by states after the peace of Westphalia. Second, we describe how the rise of positivism in the 19th and 20th century redefined the issue of validity in terms of state consent as a way to replace the foundations of natural law in the Vattelian model. However, despite the introduction of state consent, the conceptual construction of exclusive territorial authorities in the Vattelian model was left intact. Third, we present an analysis of the major transformation of the structure of authority from the end of the Second World War to the 1990s, by reviewing how commentators during those decades — from a second observer perspective—understood the legal setting that surrounded them. Finally, we will briefly map theoretical responses to these changes in the structure of authority in a global setting, trying to update or complement the original Vattelian conceptual arrangement for international law.

### **2.2.1 The Vattelian Conceptual Arrangement for International law**

At the dawn of the discipline of international law in the years following the peace of Westphalia, the fundamental question of the doctrine was the existence of a positive law of nations that could regulate the relations between sovereigns. One of the first challenges to this possibility came from the ‘Enlightenment Naturalism’ school<sup>52</sup>.

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<sup>52</sup> Enlightenment Naturalism had a different conception of traditional natural law. There were at least three important differences: First, the enlightenment’s conception of natural law did not make use of a moral, ethical and rational standard. The basis was an individualistic empirical/descriptive standard resting upon the state of nature before the social contract. Second, it rejected, to some degree, the function of custom and tradition as sources of authority or as restraints on political action. Third, Enlightenment Naturalism implied a decay in legal theory because it transformed the traditional natural law of the time from an objective “metaphysical idea” into a “nominalist political theory”, in order to justify the political changes of the time. These differences were reflected in the

Samuel Pufendorf (1632-1694) did not consider the possibility that agreements between States could be called 'laws' because their nature was 'incongruous', instead arguing that such agreements should be the subject of the study of other disciplines, such as history<sup>53</sup>. Since the only two kinds of law considered at that time were natural law and positive law, it occurred to him that only natural law could regulate international relations.<sup>54</sup>

Vattel also considered that relations between nations must be governed by natural law, though his contribution to the development of international law was more significant, with his book *Law of Nations* becoming a defining work for the discipline.

Vattel, under the strong influence of Hobbes,<sup>55</sup> saw nations and states as synonymous in defining societies of men united together for promoting mutual safety and the advantage of combined strength.<sup>56</sup> According to this logic, if states are composed of naturally free men, sovereign states ought to be considered as a multitude of free people living together. By the same logic, the law of nature that applies to men must also be applied to the common will of nations, a perspective which he synthesizes thus: 'the law of nations is originally no other than the law of nature applied to nations'.<sup>57</sup> However, this natural stance alone did not fully explain the binding character of the written and tacit conventions that states were celebrating between them.

In order to attempt an explanation, Vattel sketches the concept of a 'lawful convention'<sup>58</sup> between states (nations) that represents an agreement in conformity

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use of the term 'Law of Nature' instead of other terms such 'ius naturale' or 'natural law'. See Stephen Hall, "The Persistent Spectre: Natural Law, International Order and the Limits of Legal Positivism" (2001) 12 *European Journal of International Law* 274-276.

<sup>53</sup> Samuel Pufendorf, *Of the Law of Nature and Nations: Eight Books* 1717. Book II, Ch III, 152.

<sup>54</sup> Hall (n 52) 274.

<sup>55</sup> Vattel refers to Hobbes work as the 'hand of a master' in Emer Vattel, *The Law of Nations or Principles of the Law of Nature Applied to the Conduct and Affairs of Nations and Sovereigns* (Clarke 1811) vii.

<sup>56</sup> *ibid.* Preliminaries iv and Book I Ch 1, 1.

<sup>57</sup> *ibid* lvi.

<sup>58</sup> *ibid* lviii.

with the law of nature, whether this convention was tacit in the form of customary, or written in the form of a treaty. This distinction allows a conceptual space for states to celebrate any type of agreements as long as they do not contravene the law of nature. In Vattel's terms, that implied the ability of a state to enter into any particular engagement with others, while remaining bound to the performance of their 'duties to the rest of mankind'<sup>59</sup> embodied in the respect of natural law.

Vattel was not the first thinker of his time to analyze the nature of the agreements between sovereigns as a separate field of study, but he did so with the greatest depth and provided a clear conceptual model for understanding the new field. For instance, Alberico Gentili (1552-1608) had earlier undertaken a systematic analysis of international law as a different field from the domestic law of states, and from theology<sup>60</sup>. However, Gentili did not provide a clear explanation about the nature of this law, when he referred to the agreements between nations as 'contract of sovereigns'<sup>61</sup> based upon good faith, and regulated 'so far as possible by civil law and reason'.<sup>62</sup>

Vattel went further and arrived at a more detailed conception of the positive law of nations that encompasses a clear standard of self-compliance and a concept of authority that was not evident in the work of his predecessors. Emmanuelle Jouannet refers to this as the 'Vattelian moment', where everything came back to the state, 'as a juristic person and the exclusive subject of international law, with the list of its rights and duties' in times of peace and war<sup>63</sup>.

Vattel's model allows one to further divide this type of law into three categories: voluntary, for presumed consent of the state; conventional, for express

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<sup>59</sup> *ibid* lx.

<sup>60</sup> Gezina Hermina Johanna Van Der Molen, *Alberico Gentili and the Development of International Law His Life Work and Times* (Paris 1937) 241.

<sup>61</sup> Alberico Gentili, *De Iure Belli Libri Tres: The Photographic Reproduction of the Edition of 1612* (Clarendon Pr 1933) Book III, ch XIV, 361

<sup>62</sup> Gentili mentioned: 'The treaties and agreements of princes ought to be regulated so far as possible by civil law and reason, says Alciati', *ibid* 365.

<sup>63</sup> Emmanuelle Jouannet, *The Liberal-Welfarist Law of Nations a History of International Law* (Cambridge University Press 2012) 112; see also Vincent Chetail, *Vattel's International Law from a XXIst Century Perspective* (Nijhoff 2011).

consent; and customary for tacit consent of the state. In addition, it provided a standard of self-compliance—that would fall under the label of moral legitimacy—in conformity with the degree that agreements between states followed natural law.<sup>64</sup> Finally, it provides a clear definition of the source of public authority. Vattel wrote:

it is necessary that there should be established a public authority, to order and direct what is to be done [...] this political authority is the sovereignty; and her or they who are invested with it are the sovereign [...]<sup>65</sup>.

With this definition, Vattel encompasses the forms of government of the time (i.e. democracy, aristocratic republic, and monarchy), but most importantly he provided a definition that was compatible with the reality created a century before during the arrangements of the peace of Westphalia. This means that the construction of a positive law of the states is made compatible with the existence of a political configuration of territorial exclusive public authorities. This is what would henceforth be termed the Vattelian setting or configuration of international law, meaning that one nation possesses only one exclusive public authority (state) over a defined territory which in turn can be engaged in agreements with equals, as long as those engagements do not contradict the law of nature (fairness). The science that ought to study such types of agreements was the positive law of nations.

The nature of this concept of a positive law of nations, as the product of the will of sovereigns, can be better understood in this passage where Rafael Domingo notes how Vattel has transferred the concept of *patres familias*, from Roman law to the law of nations. Domingo notes:

In order to describe his notion of the modern state in the cosmos of the community of states, Vattel took into account the figure of the Roman *pater familias*, especially in his relations with other *patres familias*, as full subjects of applicable law, the *ius civile*. For Vattel, each state was basically like a Roman family, subject to the absolute power

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<sup>64</sup> Vattel (n 55) lxvi.

<sup>65</sup> *ibid* Book I, ch 1, 1.



of the pater. He saw relations between sovereign states as similar to those between *patres familias*.<sup>66</sup>

In this way international law has a Vattelian nature in which states are still seen as *patres familias*, the only representatives of their people's interests, and where international law is reduced to the conventions – tacit or express – between them. Vattel did not use the word legitimacy, as it was not a word included in the legal discourse of those times, but he created a conceptual model and logic that took on the issues of validity, public authority, and the justification of the authority in his day.

Below, it is argued that this logic was maintained in the following centuries, despite the switch from natural law to positivism. However, the break in this logic in the years after the Second World War, with the arrival of new non-state actors in the international legal sphere, meant political and legal debates came to be discussed by scholars under the veil of '*legitimacy*'. International Investment Law, like some of the normative regimes that were created at the end of the 20th and the beginning of the 21st centuries were developed precisely due to this departure from Vattelian logic, as will be explained in further detail.

### **2.2.2 The Revision of Positivism and the Debate on the Validity of International Law**

The classical legal positivism that arose in the 19th century in response to the earlier naturalistic trends, impacted the development of international law as a scientific discipline, and introduced a debate that had been absent in previous years on the validity of norms. However, it will be argued below that these debates about validity did not replace the Vattelian conception of international law as based on the exclusive authority of states over territories: on the contrary, it radicalized this conception. The emergence of classic positivism removed any reference to natural law, and by doing so it removed the standard of lawfulness for obedience that the Vattelian conception had provided. Later, the positivistic trend would evolve with

<sup>66</sup> Rafael Domingo, "Gaius, Vattel, and the New Global Law Paradigm" (2011) 22 *European Journal of International Law* 637

the addition of debates about the validity of legal systems, but the conception of international legal settings under exclusive legal authorities would remain. This meant that the justifiability of international law moved from the dogma of natural law, to one of state consent.

Categorizing the conventions between states as 'law' was the first problem addressed by the new trend of classical positivism, which denied this condition to international law. The grounds for denial were different from those put forward by early naturalists like Pufendorf, who also refused to consider international law in the category of positive law.

The positivist's classical understanding of the word 'law', especially that of John Austin (1790–1859), was a vertical one. This conceptualization of law cannot be better described than in the strong opening line of his book 'Providence and the Jurisprudence Determined'<sup>67</sup>. In fact, this sentence was powerful enough to trouble theorists<sup>68</sup> for the following century: '*The matter of jurisprudence is positive law: law, simply and strictly so called: or law set by political superiors to political inferiors.*'<sup>69</sup>

This implied that in order to establish the existence of law, one needed a sovereign who could impose rules on an independent political society, based on fear of sanctions<sup>70</sup>. Under this vertical perspective, the source of law was connected to the will of the sovereign, and since international law represents agreements between equals, its study should fall in the domain other sciences such as 'positive morality'<sup>71</sup>, but could not be considered within the science of jurisprudence.

This original understanding of law did not capture the reality of the behavior of the states that tended to deal with the agreements between them as 'law'. In other words, in the absence of a political superior among nations, states felt the duty to

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<sup>67</sup> John Austin, *The Province of Jurisprudence Determined* (Weidenfeld & Nicolson 1954).

<sup>68</sup> For the impact of this phrase in the following century, see David Kennedy, "International Law in the Nineteenth Century: History of an Illusion", (1998) 17 *Quinnipiac L.R.*

<sup>69</sup> Austin and Rumble (n 25) 18.

<sup>70</sup> See *ibid* 18.

<sup>71</sup> Hall (n 52) 281

comply with the set of rules that had been accorded either expressly in treaties or by custom. Stephen Hall summarized this situation in the following way:

States continued to regard international law as real law, they continued to abide by its rules in the vast majority of cases, their diplomatic communications continued to bristle with claims and counter-claims of legal right, and they continued to sign treaties by which they regarded themselves and other states as legally bound<sup>72</sup>

In order to adjust the positivist core ideas to the reality and practice of the time, at least two revisions of the Austinian vertical idea of law were generated by the doctrine. The first one was proposed by Georg Jellinek (1851 -1911), who sought an answer to the debates among German constitutional law scholars regarding the scientific foundations of the so called ‘modern law of nations’<sup>73</sup>. He believed that there could be no other conceptual grounding for international law than the free will of nations. He argued that the binding nature of the law was not a normative-theoretical manifestation, but a psychological manifestation of ‘the feeling to have obliged oneself’<sup>74</sup>. Therefore, states could impose upon themselves international obligations by the self-limitation of their own sovereignty<sup>75</sup>.

The shortcoming of this idea was that if the source of international legal obligations was the will of the states, the same state could retreat from the binding character of an agreement by removing the same will —making the existence of any international legal system outside the state fragile. In order to maintain the core ideas of positivism, he referred to international law as the public law of an international legal community, where a type of ‘proto-constitution’ existed somehow liberated from State-consent<sup>76</sup>.

Heinrich Triepel (1868-1946) also contributed with a second idea refining this positivistic stance towards international law. He did this by moving the source

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<sup>72</sup> *ibid* 282

<sup>73</sup> Jochen von Bernstorff, "Georg Jellinek and the Origins of Liberal Constitutionalism in International Law" (2012) 3 *Goettingen Journal of International Law* 4, 660.

<sup>74</sup> *ibid* 669.

<sup>75</sup> Hall (n 52)

<sup>76</sup> Bernstorff (n 73) 662.

of bindingness in international law, away from the sole will of one state, and placing it in the idea of a common will of states<sup>77</sup>. This idea meant that if states gave their consent to the creation of an international obligation, they were no longer free to remove such consent by a unilateral act.

The establishment of the core ideas of positivism<sup>78</sup> for the justification of international law —mainly to restrict the basis for international law to the consent of sovereigns instead of some universal natural law— implied new logical puzzles for theorists. Most of these new questions were related to the notion of the validity of norms, and resulted in the monistic vs. dualistic approaches to the legal system that continued to dominate for decades.<sup>79</sup>

In the following years, new ideas in the positivistic vein maintained the concept of the vertical structure of law, and extended it to the notion of legal order. For example, Kelsen was very careful to maintain the distance between legal order and other types, such as moral law. He insisted that positive moral orders could not attach a sanction, while law prohibits behavior specifically by attaching negative

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<sup>77</sup> Mehrdad Payandeh, "The Concept of International Law in the Jurisprudence of H.L.A. Hart", (2011) 21 *The European Journal of International Law*, ibid 971.

<sup>78</sup> There are several ideas related to this term, but in the context of international law it is useful to recall Weil's conceptualization of positivism: 'This term, of course, is not meant to imply that it should be regarded as an essential characteristic of international law that all its norms be "posited" by "formal sources" or result from precise normative facts without ever being the fruit of "spontaneous" formation.' No, it is simply intended to emphasize the necessity of envisaging international law as positive law, i.e., as *lex lata*. This means that (as already suggested) the distinction between *lex lata* and *lex ferenda* must be maintained with no abatement of either its scope or its rigor.' Prosper Weil, "Towards Relative Normativity in International Law?", (1983) 77 *AJIL*. 421

<sup>79</sup> Few authors escaped the monism-dualism dichotomy that dominated those years in the theory. In this context, it is worth mentioning the work of Santi Romano, who elaborated a construction of the autonomy of different types of sources, without labeling them as pluralism (or dualism), leaving the door open for the coexistence of normative orders. He wrote: "Anzi tutto le fonti rispettive, che sono perfettamente autonome, perché carattere originario hanno così la comunità internazionale come lo Stato: l'esistenza del Diritto internazionale non dipende dal diritto statale, e viceversa. Il primo non può costituire il secondo, né sopprimerlo, né dichiararlo invalido..." Santi Romano, *Corso Di Diritto Internazionale* (Cedam 1939) 46-47.

sanctions to the contrary behavior<sup>80</sup>. In addition, Kelsen distinguished himself from early trends in the vertical conception of the law, such as Austin's, in the sense that he constructed his theory considering the existence of validity drawn from a superior norm. This construction allowed him to distinguish law from other orders, such as moral ones, but it did not make coercion a central element in the concept of law. As a result, and after the influence of the thinkers in the 19th and early 20th centuries, this construction came to be considered positivistic for the most part since its conceptual configuration of international law made state consent the source of validity.

This without a doubt influenced the emergence of article 38 of the Statute of the International Court of Justice (SICJ) as the center of the argumentation and analysis of legal obligation for adjudicators in general. The text of the article is the same as that in the Statute of the Permanent Court of arbitration of 1920. The version incorporated into the SICJ in 1948, added a second part to the article that recognizes the ability of the International Court to decide cases in *ex aequo et bono*. This inclusion puts an emphasis on the character of the first part of the article as sources of 'law'.<sup>81</sup>

The article is supposed to recognize that the International Court will decide the cases submitted for its adjudication considering the following sources: (a) international conventions; (b) international custom; (c) general principles of law recognized by 'civilized nations' as primary sources and (d) judicial decisions and teachings of a 'qualified publicist' as subsidiary means. The first two sources come directly from state consent either in an express or tacit form, while the contours of the third —general principles of law— are different because they even make a reference to the sources recognized by nations rather than states.

Even though the text of Article 38 does not make any distinction or mention any type of hierarchy between the sources of the law, Kelsen goes further and questions the existence of these principles. For him, it is doubtful whether such principles common to the legal orders of the civilized nations exist in the context

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<sup>80</sup> JÖRG KAMMERHOFER, "Kelsen – Which Kelsen? A Reapplication of the Pure Theory to International Law" (2009) 22 *Leiden Journal of International Law* 228

<sup>81</sup> Hall (n 52) 284.

of the ideological antagonism between communist and capitalist countries, as well as between autocratic and democratic legal systems.<sup>82</sup> Therefore, if the principles referred to by Article 38 exist, for Kelsen they may only be used in the absence of a norm that can be derived from state consent.

During the years of the interwar period of the 20th century, the natural law standard was removed and replaced by state consent. Then Article 38 (a), (b) of the Statute of the Court of Justice became the center of normativity. However, a closer look at this conceptual move away from natural law as the standard of lawfulness, and as a justification of obedience to state consent, only results in the modification of the Vattelian construction of international law.

Furthermore, the shift from natural law to state consent resulted in an even more radical model than the Vattelian one, by placing the validity of the agreements between states as *Patre Familias*, the sole representatives of individuals, at the center. While in the 18th century these agreements could not contravene the standard of lawfulness conceptually embodied in natural law, in the 20th century, agreements took center stage, using the same logic of exclusive territorial authority.

Therefore, the world would start to reconstruct its economic order after the Second World War, with a radicalized version of the Vattelian arrangement. Soon after, the global society would begin to change as new forms of normativity started to emerge. Normative—as well as political tensions—would arise and inevitably result in claims and resistance to (and from) the newly emerging types of public authorities.

### **2.2.3 The Road from Schwarzenberger to Franck and the Emergence of a New Global Legal Setting in the Second Part of the 20th Century**

The process of development of international law into the current configuration in a global setting began after the Second World War, but accelerated over the last decade of the 20th century when the Soviet Union collapsed. The changes experienced by a global society caused the development of norm generation

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<sup>82</sup> See Hans Kelsen, *Principles of International Law* (Holt [u.a.] 1967) 539-540.

processes outside of nation states, with the emergence of new forms of public authority.

This development comprised two main features: (i) the normative specialization into treaty regimes in international law; and (ii) the activity of different ‘social spheres’<sup>83</sup> beyond the authority of nation-states, which generated a series of clashes between legal systems along vertical, horizontal, and transnational dimensions.

First, the normative specialization must be tracked back to the post-war period in the middle of the 20th century. In order to understand the state of international law in this post-war period, it is useful to recall the picture that Georg Schwarzenberger (1908–1991) sketched of the problems faced by scholars who attempted to analyze the situation of International Economic Law during these years. He wrote:

The science of international law is confronted with an issue which has been faced long ago by every mature and self-respecting system of municipal law. Any such system required the kind of treatment which one may expect to find in a competent book or course on Jurisprudence or English Legal System. Side by side, however, with these general topics, there are the various branches of municipal law. They are recognized as proper subjects for separate and technical treatment. An English lawyer would not expect to find a detailed picture of the laws of Contract, Tort, Evidence, Commercial Law or of Conflict of Laws in a bird's-eye view of English law. Yet this is the amorphous state in which international law still is. [...] It would seem that the time has come for the establishment of separate branches of international law.<sup>84</sup>

International law was not responding to the exigencies of societies which needed legal instruments on an international level to address problems such as the reconstruction of the economic world order in the post-war period. It is not a coincidence that Schwarzenberger used the word ‘amorphous’ in order to describe

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<sup>83</sup> Gunther Teubner, *Constitutional Fragments Societal Constitutionalism and Globalization* (Oxford Univ. Press 2012) 1.

<sup>84</sup> Georg Schwarzenberger, "The Province and Standards of International Economic Law" 2 (3) (1948) Cambridge University Press *The International Law Quarterly* 404.

the state of international law. In the following decades, the establishment and the foreseen development of branches, as well as a substantive expansion (e.g. Human rights, International Economic Law, International Criminal Law, International Investment Law, etc.) took place. This normative development was accompanied by an increase in the number of institutional adjudicative bodies. In the case of International Economic Law, the discipline witnessed the creation of the World Trade Organization (WTO) after decades of rounds of negotiation, and an exponential increase in Bilateral Investment Treaties - BITs.

By the end of the 20th century a completely different arrangement was evident with the presence of a robust normative and institutional universe. Thomas Franck (1931–2009), four decades later in the same line, as if answering Schwarzenberger's concerns, noted:

The time when any one scholar could give a definitive overview of the whole of Public International Law is past. Nowadays, scholars and practitioners choose to specialize [...] <sup>85</sup>. This specialization reflects the fact that the law of the international community has, through maturity, acquired complexity. <sup>86</sup>

The doctrinal visions of commentators provide pictures of the legal world that they face, so it is useful to recall the evolution and direction of these changes. Somehow, the international community had managed to move from Schwarzenberger's 'amorphous' global legal world to the mature and complex one perceived by Franck. In fact, this perception of the state of international law is one of Franck's premises for considering a post-ontological form, in which questions regarding the discipline must switch to concern for the fairness and

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<sup>85</sup> Franck mentioned as fields of specialization: "international tort or criminal law; international resource law or the law of human rights; aviation or law of the seas; communications law or space law; sovereign or diplomatic immunities; conflict of jurisdictions, or of intergenerational aspects of antitrust law or international tax law; the law of international organization or of international waterways" Thomas M. Franck, *Fairness in International Law and Institutions*, (Oxford University Press, 1997). 5

<sup>86</sup> *ibid* 5



legitimacy of a complete legal system.<sup>87</sup> International law as a science began to include the word 'legitimacy' in its debates.

In order to analyze the debate surrounding legitimacy in the current legal setting we also need to understand the deep changes that took place in global society during those decades. These changes were not only political, but involved the structure of global society as a whole, and consisted in the emergence of fragments of society that generated epistemic and transnational communities producing normative orders and new types of relative authorities at the sociological level. These sociological dynamics were the engine behind the expansion of normative creation outside of nation-states.

Therefore, the decades after the great wars represented the erosion of the concept of absolute sovereignty, with the result that states in their Westphalian form started to lose their monopoly on the creation of law outside their own territory. This statement does not mean that states no longer control the process of creation of international law but rather that they are no longer the sole actors. They now co-exist not only with international organizations that limit their power, but also with a series of norm generation processes arising from global sectors of society outside their sphere.

Concepts like the role of the state have dramatically changed in the last decades, and international law cannot be seen only as the law or as agreements between sovereign nations that exercise a limiting and exclusive authority over a specific territory. In this sense, today's legal problems, such as the ones posed by International Investment Law, cannot be dealt with only by states with exclusive territories, populations and 'governing arrangements',<sup>88</sup> because they arise from realities that include not only the flows of capital and trade around the world, but also the creation of communities and social networks beyond a specific territory.

The first description of such changes in the doctrine can be found in the Storrs lectures of Philip Jessup (1897-1956), who already noted:

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<sup>87</sup> Ibid 6

<sup>88</sup> Neil Walker, "Beyond Boundary Disputes and Basic Grids: Mapping the Global Disorder of Normative Orders" (2008) 6 *International Journal of Constitutional Law* 373.

Part of the difficulty in analyzing the problems of the world community and the law regulating them is the lack of an appropriate word or term for the rules we are discussing. Just as the word “international” will not do. (...) My choice of terminology will no doubt be equally unsatisfactory to others. Nevertheless, I shall use, instead of “international law” the term “transnational law” to include all law which regulates actions or events that transcend national frontiers. Both public and private international law are included, as are other rules which do not wholly fit into such standard categories<sup>89</sup>

I do not intend to embrace the term ‘transnational law’ introduced by Jessup in the context of an entirely legal academic discipline<sup>90</sup> because it is beyond the scope of this analysis, but his words provide a close look at changes and how they impacted legal science. Jessup refers explicitly to the problems of ‘world community’. It is not a reference to a community of states and even more it acknowledges that the term “international law” is misleading for describing all the activities that have begun to be undertaken outside the state.

Even the integration processes that were originally conceived as organizations created by states started to behave otherwise; it is useful to recall the famous lines of the European Court of Justice, in the foundational *Van Gend En Loos* Case:

the Community constitutes a new legal order of international law for the benefit of which the states have limited their sovereign rights, albeit within limited fields, and the subjects of which comprise not only Member States but also their nationals.<sup>91</sup>

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<sup>89</sup> Philip C. Jessup, *Transnational Law* (Yale University Press 1956) 1-2.

<sup>90</sup> In this sense, see the analysis in Roger Cotterrell, "What Is Transnational Law?" (2012) 37 *Law & Social Inquiry*.

<sup>91</sup> *Van Gend En Loos v Nederlandse Administratie der Belastingen* (Case 26/62) European Court of Justice 1963 (Judgement 12).

The reference to a 'new legal order' was then clarified one year later in the *Costa vs. ENEL* case where the same court referred to its 'own legal system'<sup>92</sup> created in the EEC Treaty. Even though the new legal order was conceived in the EEC Treaty, the arrangements were different: states were no longer the sole actors and the *patres familias* logic was starting to change.

On the other side of the Atlantic, a couple of years later in 1968, McDougal, Lasswell, and Reisman, were engaged in their work and the development of their New Haven Jurisprudence school. They felt the need to describe the world society that they were facing and therefore wrote:

People cross national boundaries in numbers and with a regularity which have never before been achieved. The ebb and flow of persons has not been restricted to the highly publicized inter-governmental contacts. People for all sectors of national communities travel and intermingle in striving to maximize their wealth, their skill, their understanding and, even, their prestige<sup>93</sup>. [...] The quality of a harvest in the Ukraine affects the commodities ex-change in Chicago; a rail strike in Sweden disrupts or debilitates rail traffic in France; a copper strike in Chile closes factories in the US. Business planning here must concern itself, not only with labor relations in an American city, but in the mines of Africa and Latin America from which some of its vital raw materials come, the maritime and transport unions of a number of states, which participate in distribution, and national marketing unions at many different points of final consumption [...] <sup>94</sup>

Those lines could perfectly describe the economic turbulences of our times, yet the description is from 1968, a time before the internet. In particular, it is also relevant that in their legal theoretical writings, the proponents of such schools

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<sup>92</sup> *Flaminio Costa v Ente Nazionale Energia Elettrica Enel* (Case 6/64) European Court of Justice 1964.

<sup>93</sup> Myres S McDougal, Harold D Lasswell and W. Michael Reisman, "Theories About International Law: Prologue to a Configurative Jurisprudence" (1968) *Yale Law School Legal Scholarship Repository Faculty Scholarship Series. Paper 673*. In: <  
[http://digitalcommons.law.yale.edu/fss\\_papers/673](http://digitalcommons.law.yale.edu/fss_papers/673)>.

<sup>94</sup> *ibid* 190-192.

entered into such detailed descriptions of the changes they witnessed, as premises for their methodological propositions.

Nowadays, the picture of our global society is very different from that of 1968; people are now directly connecting around the world, new transnational actors have gained relevance in the international context, from multinational corporations, NGOs, hedge funds, offshore markets, and many more—even criminal and terrorist groups operate in a transnational way. The dynamics that McDougal, Lasswell, and Reisman witnessed at the end of the sixties did not stop: they intensified.

The Vattelien arrangement was and still is present because states have continued to base their relations on international law and treat their agreements as law, but these relations coexisted with emerging types of authority from different normative orders created by various sectors of global society. Indeed, public authority stopped being *territorially exclusive* and new forms of authority, generated in different normative orders, started to coexist. Each normative order that emerged brought its own sectorial logic, its own values, its own ‘legitimacy’.

Clashes between authorities became inevitable when points of contact between two or more authorities started to occur, especially where there were no territorial limits. Each clash represented an encounter between rationalities that might have been in contradiction with one another. This in turn led to intersystem conflicts of law in three dimensions: horizontal, between normative systems of states; vertical, between states and supranational structures; and transnational between normative systems developed by fragments of society, as will be explained (Section 1.3). Many of the tensions described would be placed behind the veil of the linguistic term ‘legitimacy’ over the ensuing years.

### ***2.3 The 21st Century and the New Theoretical Gap***

The Vattelien conceptual arrangement, designed for inter-state relations, and modified by the positivists in the 19th and at the beginning of the 20th centuries, did not capture the whole complexity of the global legal setting by the beginning of the nineties; furthermore, neither the theoretical tensions between naturalists and

positivists, nor the old dichotomy between monism and dualism, provided clear-cut answers to normative conflicts.

In the 21st century, the states as *Patres familias* of their populations are not alone in the norm generation processes outside their borders. Not only have individuals started to gain access to international adjudicative mechanisms, but also functional fragments of society have started to generate overlapping normative orders, along with the creation of forms of relative public authority outside the state.

These fundamental changes have also implied the existence of a new conceptual gap, between the Vattelien arrangement of inter-state law and the new types of normativity. New theoretical enterprises have emerged to fill this gap along with new vocabulary which began to appear in legal debates from the nineties. In this context, words like ‘fragmentation’, ‘cosmopolitanism’, ‘governance’, and ‘pluralism’, along with an evocation of the notion of ‘the global’<sup>95</sup>, began to be developed and used for specific political purposes.

As Jacob Katz Cogan said: ‘fragmentation is an idea, and like all ideas, it has a history and a politics’.<sup>96</sup> The same can be said about other vocabulary, but especially about ‘legitimacy’, which implies —contrary to fragmentation— a resistance or a claim of authority. The insertion of new vocabulary attempts to complete the Vattelien setting for international law. It is not inside the scope of this work to provide a full map for all of these theoretical enterprises, but the following lines will provide an approximation of the trends and vocabulary that affect the perception of international investment law.

### **2.3.1 Tomas Franck and Legitimacy Debates in International Law.**

Thomas Franck witnessed how the new configuration affecting the production of norms in international law at the end of the 20th century intensified, though it was

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<sup>95</sup> Neil Walker, *Intimations of Global Law* (Cambridge Univ. Press 2015).

<sup>96</sup> Jacob Katz Cogan, "Fragmentation of International Legal Orders and International Law: Ways Forward?" (2011) 105 *Proceedings of the Annual Meeting American Society of International Law* 123.

not exclusively caused by the collapse of the Soviet Union<sup>97</sup>. He described the times as constituting the 'post ontological' era of the discipline, meaning that existential questions had been left behind. It was clear that despite the major normative generation of new treaties, states continued to comply with them, as Louis Henkin famously noted:

It is probably the case that almost all nations observe almost all principles of international law and almost all of their obligations almost all of the time. Every day nations respect the borders of other nations, treat foreign diplomats and citizens and property as required by law, observe thousands of treaties with more than a hundred countries<sup>98</sup>

Franck started to wonder about the existence of an 'X factor'<sup>99</sup> that makes states comply with international norms in the absence of factors of coercion as suggested in the Austinian conception of law. In 1987, Franck introduced the question '*Why a Quest for Legitimacy?*'<sup>100</sup> in the international law legal debate, In the following years, he would advance a theory of legitimacy for international law, beginning with his 1990 book '*The Power of Legitimacy among Nations*'. In 1992, he presented a paper at the Annual Meeting of the American Political Science Association in Chicago<sup>101</sup>; later at The Hague Lectures in Public International Law<sup>102</sup>, and finally expanded his argument in 1995 with his book '*Fairness in international law and institutions*'<sup>103</sup>. Even though he would continue to refine his theory in the following years, this book can be considered the centerpiece of his

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<sup>97</sup> A question beyond the scope of this present work, is how this global social dynamic may have influenced the implosion of the Soviet Union.

<sup>98</sup> Louis Henkin, *How Nations Behave Law and Foreign Policy* (Columbia Univ. Press 1979).

<sup>99</sup> Thomas M. Franck, *The Power of Legitimacy among Nations* (Oxford Univ. Pr 1990) 48

<sup>100</sup> Thomas M. Franck, "Why a Quest for Legitimacy?" (1987) 21 *University of California*.

<sup>101</sup> Quoted by Anne-Marie Slaughter, "International Law and International Relations Theory: A Dual Agenda" (1993) 87 *American Journal of International Law*.

<sup>102</sup> Harold Hongju Koh, "Why Do Nations Obey International Law?" (1997) *Yale Law School Legal Scholarship Repository. Faculty Scholarship Series Paper 2101*.

<[http://digitalcommons.law.yale.edu/fss\\_papers/2101](http://digitalcommons.law.yale.edu/fss_papers/2101)> 2602 accessed 08 October 2015.

<sup>103</sup> Thomas M. Franck, *Fairness in international law and institutions* (Oxford Univ. Pr 1998)

work because it encompasses the description of legitimacy as a sociological concept and also addresses the component of distributive justice (moral legitimacy).

Franck helped to introduce a debate about 'legitimacy' in the context of international law. He was probably not the first author who used the word 'legitimacy' but he addressed this issue in a way that had the greatest influence on the legal scientific debate. The scholars that followed him either contested<sup>104</sup> or expanded on his ideas<sup>105</sup>.

The relevance of Franck's work can also be attributed to the fact that his theory uses all forms of positivism to address non-typical positivist questions such as the fairness of international law. In other words, he managed to present a sociological and legal version of legitimacy, moving away from the concept of distributive justice as justifiability (moral legitimacy). For Franck, two Vectors<sup>106</sup> are the requisites for fairness in international law: legitimacy is concerned with order (procedural fairness), while distributive justice is concerned with change (moral fairness).<sup>107</sup>

The fairness construction of Franck is constructed within the paradigms of the positivistic evolution. He presents a collection of ideas from Austin, to revisions of Jellinek and Triepel—even though he does not mention them—and finishes with the rules of recognition of Hart. His paradigms are as follows: first, states are sovereign and equal; second, sovereign states can only be restricted by consent; third, consent binds; and fourth, states joining the international community are bound by the rules of the community.<sup>108</sup> Then, in the same vein, he appeals to Herbert L. A. Hart's (1907–1992) distinction between primary and secondary rules.<sup>109</sup> Hart established that any mature system needs two types of rules. Rules of the first type, or *primary rules*, are the ones that determine rights and obligations,

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<sup>104</sup> One of the strongest critics came from Harlod Koh, who stated that Franck's account fails to explain why a rule penetrates a domestic legal system, thus becoming part of that nation's internal value set. See further in Koh 2603

<sup>105</sup> Iain Scobbie, "Tom Franck's Fairness", (2002) 13 *European Journal of International Law*. 910

<sup>106</sup> Ibid.

<sup>107</sup> Franck 7-9 Scobbie.

<sup>108</sup> Franck.

<sup>109</sup> See Chapter V, Hart and Bulloch. And the analysis of Franck 30

and rules of the second type, or *secondary rules*, are the ones that specify the process by which primary rules are created or modified. This latter type are also known as ‘rules of recognition’. If primary rules are not based on the secondary rules or rules of recognition, it seems logical that legitimacy is at stake. However, the fact that a primary rule comes from a secondary rule does not mean that it is always legitimate, so Franck provides indicators of legitimacy, especially for the primary rules.

Franck’s four indicators of legitimacy are: first, textual ‘determinacy’, meaning the ability of a text to convey a clear message<sup>110</sup>; second, ‘symbolic validation’, implying that the attribute of law to communicate authority is being exercised in accordance with right process (e.g. ritual and pedigree<sup>111</sup>); third, ‘coherence’, involving the generality of the principles that apply,<sup>112</sup> and the predictability of their application; and four, *adherence*, defined as the ‘vertical nexus’<sup>113</sup> between a single primary rule and a pyramid of secondary rules in a system. Therefore, the fourth element is the verification of the ‘rules of recognition’ of every system in Hart’s conceptualization.

This theory is still based on the inter-state conceptual setting, meaning that it only sees normativity coming from or linked to state consent, so in this sense it does not fill the theoretical gap to help us understand and operate in a context of overlapping communities. In other words, in the context of pluralism, different concepts of determinacy, symbolic validation, coherence, and adherence can coexist or collide.

### 2.3.2 The Debate on Fragmentation

Despite this resistance to change, some sectors within the discipline reacted to the new global setting as the debates on the fragmentation of international law began. It was not a coincidence that the dangers of the proliferation of courts and norms were brought into the legal debate by two judges of the International Court (ICJ),

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<sup>110</sup> Franck.

<sup>111</sup> *ibid* 34.

<sup>112</sup> *ibid* 38.

<sup>113</sup> *Ibid* 41.



whose Statute contains Article 38, the core of the conceptual arrangements of international law as a discipline.

In the year 1999, the president of the International Court of Justice ICJ, Judge Stephen M. Schwebel, welcomed the development of the creation of specialized international tribunals that were ‘forced’<sup>114</sup> into existence by the entrance of new actors. However, at the same time, the possibility for ‘substantial conflict’<sup>115</sup> among new adjudication bodies remained; this could have been prevented if the ICJ had been empowered through an extension of its capacities and by allowing other international tribunals to request advisory opinions from the ICJ on issues of international law.

In the next year, Schwebel’s successor, Judge Gilbert Guillaume, introduced a deeper concern,<sup>116</sup> by contributing another new term to the legal debate: the word ‘fragmentation’ contextualized as a danger. Once again, this manifested the need for the International Court of Justice to be empowered with resources to overcome these challenges. He said:

Judges themselves must realize the danger of fragmentation in the law, and even conflicts of case-law, born of the proliferation of courts. A dialogue among judicial bodies is crucial. The International Court of Justice, the principal judicial organ of the United Nations, stands ready to apply itself to this end if it receives the necessary resources.<sup>117</sup>

In this context, in 2000, the International Law Commission decided to include the topic of fragmentation in its scope of work. In 2002, the Commission expanded research by establishing a Study Group<sup>118</sup> on this issue that concluded in

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<sup>114</sup> *Address to the Plenary Session of the General Assembly of the United Nations by Judge Stephen M. Schwebel President of the International Court of Justice, 26 October 1999.*

<sup>115</sup> *Ibid.* Commented by Martti Koskenniemi and Päivi Leino, "Fragmentation of International Law? Postmodern Anxieties" (2002) 15 *Leiden Journal of International Law* 554-555

<sup>116</sup> Koskenniemi and Leino.

<sup>117</sup> *Address by H.E. Judge Gilbert Guillaume, President of the International Court of Justice, to the United Nations General Assembly, 26 October 2000.*

<sup>118</sup> This was finished by Martti Koskenniemi.

the year 2006 with the report: 'Fragmentation of international law: difficulties arising from the diversification and expansion of international law'<sup>119</sup>. The report chose to deal only with the substantial or normative side of fragmentation, meaning those conflicts that arise in a particular case: 'where two rules or principles suggest different ways of dealing with a problem'<sup>120</sup>.

It is not clear to what extent substantial fragmentation can be understood without dealing with institutional fragmentation. However, the report does acknowledge the idea of functional differentiation, understood as 'the increasing specialization of parts of society and the related autonomization of those parts'<sup>121</sup>. In addition, while the report acknowledged the existence of self-contained regimes containing their own principles, their own form of expertise and own 'ethos'<sup>122</sup>, in its conclusion it stated that problems arising with these regimes must be understood as problems of interpretation. The report concludes with a strong call for unity in international law, and a clear statement on international law as a legal system<sup>123</sup>. In this context, any conflict between 'ethos' must result in a normative conflict where there is only one criteria of validity, and in case of two valid norms, one should prevail for any of the interpretative criteria developed in the report.

In the full report and in the conclusions, there is only one mention of the word 'legitimacy'.<sup>124</sup> While referring to the development of international law in a regional context, the report states that: 'The presence of a thick cultural community better ensures the legitimacy of the regulations and that they are understood and

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<sup>119</sup> International Law Commission, "Report a/Cn.4/L.682 on Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law" (International Law Commission, 2006).

<sup>120</sup> Ibid. para 25

<sup>121</sup> ibid para 7, 11

<sup>122</sup> International Law Commission, "Conclusions a/Cn.4/L.702 on the Report of Fragmentation of International Law: Difficulties Arising from the Diversification and Expansion of International Law, Conclusions" (United Nations, 2006) para 10.

<sup>123</sup> ibid Conclusions, para 1

<sup>124</sup> Commission 106 para 205.

applied in a coherent way'<sup>125</sup>. On the other hand, the report introduces references to concepts of validity (invalidity) no fewer than 90 times.

### **2.3.3 The Influence of Political Science on International Law Legitimacy Debates**

Along with the evolution of Franck's ideas, other international jurists opened the door to new approaches in international law. One of those lines was the development of approaches that combined international law with theories from international relations. Anne-Marie Slaughter was one of the first in this line with her landmark paper in 1993 'International Law and International Relations Theory: A Dual Agenda'<sup>126</sup>. In this work, she calls for conceptual adjustments, in part inspired by Franck's work<sup>127</sup>. These conceptual changes entailed a combination of analytical tools from scholarship in both International Relations and International Law (IR/IL). This idea was an answer to a call for cooperation between these disciplines that Kenneth Abbott had pioneered in an earlier work,<sup>128</sup> and that would evolve into the IR/IL school or approach to international law<sup>129</sup>.

The extensive use of International Relations methodologies in the discipline of international law, mainly by US academics, resulted in the analysis of a large quantity of political science literature by legal scholars. Consequently, approaches

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<sup>125</sup> *ibid.*

<sup>126</sup> Slaughter (n 101).

<sup>127</sup> She made express reference to Franck's 'post-ontological era', see *ibid.* 205

<sup>128</sup> Kenneth W. Abbott, "Modern International Relations Theory: A Prospectus for International Lawyers (1989)" (1989) 14 *Yale Journal of Int'l Law*. Available at SSRN: <http://ssrn.com/abstract=1402758> Last accessed 08 October 2015.

<sup>129</sup> Slaughter evolves her ideas in a series of papers. See especially, Anne-Marie Slaughter, Andrew S. Tulumello and Stepan Wood, "International Law and International Relations Theory: A New Generation of Interdisciplinary Scholarship" (1998) 92 *American Journal of International Law*.

from certain schools, mainly institutionalism<sup>130</sup> liberalism<sup>131</sup> and constructivism<sup>132</sup>, among others regained importance in international legal scholarship.

On the other side of the Atlantic, political science also influenced law in debates on legitimacy using the vocabulary from studies on the legitimacy of the European integration process. Specifically, while considering the variable of legitimacy in his study on non-compliance<sup>133</sup>, German Fritz W. Scharpf introduced a distinction between ‘input-legitimacy’ and ‘output-legitimacy’ in his 1999 book *Governing in Europe: Effective and Democratic?* a distinction that has influenced the debate at the European level.

It is believed that the vocabulary developed by Scharpf was inspired by Abraham Lincoln’s famous description of democracy referring to a government ‘by the people, of the people and for the people’<sup>134</sup>, and later inspired the work of David Easton who used input and output vocabulary to distinguish citizens’ demands from government actions<sup>135</sup>.

With this background, Scharpf first distinguished ‘input-legitimacy’ as meaning ‘government by the people’<sup>136</sup>. This refers to the degree to which the

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<sup>130</sup> Zhiyun Liu, ““Legitimacy” of International Law: The Source, Development and the Paths to Overcome Crisis” (2009) 4 *Frontiers of Law in China*.

<sup>131</sup> See for example the influence of liberalism on part of the development of Mattias Kumm’s later theory of Legitimacy, in: Mattias Kumm, “The Legitimacy of International Law: A Constitutionalist Framework of Analysis” (2004) 15 *European Journal of International Law*.

<sup>132</sup> See for example Harlan Grant Cohen, “Can International Law Work, Constructivist Expansion.pdf”, (2009) 27 *Berkeley Journal of International Law (BJIL)* ; *UGA Legal Studies Research Paper No. 09-007*.

<sup>133</sup> Jurgen Neyer and Dieter Wolf, *The analysis of compliance with international rules: Definitions, variables, and methodology*, in Michael Zürn and Christian Joerges (eds), *Law and Governance in Postnational Europe: Compliance Beyond the Nation-State* (Cambridge Univ. Press 2005) 56.

<sup>134</sup> Vivien Schmidt, “Democracy and Legitimacy in the European Union Revisited Input, Output and Throughput” (2010) 21 *Working Paper, Kolleg-Forschergruppe (KFG) “The Transformative Power of Europe”*, Freie Universität Berlin. 6

<sup>135</sup> *ibid.*

<sup>136</sup> Andrew Moravcsik and Andrea Sangiovanni, *On Democracy and “Public Interest” in the European Integration*, in Renate; Streeck Mayntz, Wolfgang, *Die Reformierbarkeit Der*

‘procedures used to decide upon a rule were in accordance with the basic principles of democratic governance’<sup>137</sup>. Contrarily, ‘output-legitimacy’ refers to ‘government for the people’<sup>138</sup> meaning that under this concept, legitimacy is obtained when a rule is ‘accepted by its addressees as adequate, just or fair, independently of the procedures that were used in its enactment’<sup>139</sup>. The discussions of legitimacy vary between these two ideas, where, for instance, it is argued that output-legitimacy<sup>140</sup> could be better obtained outside the nation-state level because, among other things, it does not require a common identity but rather ‘common interests’. However, these two concepts do not exclude each other; in this sense, Neyer and Wolf conceptualize ‘input-legitimacy’ as participation, while ‘output-legitimacy’ is categorized as social acceptance.

In the following years, the input-output EU legitimacy debate would be completed, with the conceptualization of a ‘throughput legitimacy’ that encompasses not only internal processes and outcomes but also what happens in a political system<sup>141</sup>. From a ‘throughput legitimacy’ perspective, the focus is on accountability, transparency, and openness to “civil society”<sup>142</sup>.

The input, output and throughput concepts mostly impact EU law scholarship, but sometimes they have been exported to international law debates as well, specifically for the purpose of analyzing the legitimacy of international organizations. In this case, the three main concepts dealing with ‘throughput legitimacy’ —accountability, transparency, and access— have become relevant for pluralistic accounts.

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*Demokratie: Innovationen Und Blockaden Einleitung: Festschrift Für Fritz W. Scharpf* (Campus Verlag GmbH, Frankfurt/Main, 2003) 126.

<sup>137</sup> Jürgen Neyer and Dieter Wolf in Zürn. 56

<sup>138</sup> Andrew Moravcsik and Andrea Sangiovanni in Mayntz 127.

<sup>139</sup> Jürgen Neyer and Dieter Wolf in Zürn (n 134) 57.

<sup>140</sup> Fritz W. Scharpf, *Legitimate Diversity: The New Challenge of European Integration*, in Tanja ; Cichowski Borze, Rachel, *The State of the European Union Law, Politics, and Society*, (Oxford University Press, 2003) 80.

<sup>141</sup> Schmidt 8

<sup>142</sup> *ibid.*

Whether considering IR/IL scholarship or EU's 'input-output-throughput' enthusiasts, political science had an unquestionable impact on international law scholarship at the end of the 20th and start of the 21st centuries. This is because self-compliance and obedience to power have been primary points of concern; however, as with any cross-disciplinary research agenda, one must sound a note of caution regarding the challenges of implementing two sciences with different objectives and methodologies<sup>143</sup>.

### 2.3.4 The Kantian Cosmopolitan Approaches

In recent decades, there has also been a rise in the number of conceptual arrangements related to the idea of cosmopolitanism, either as descriptive or ideal forms. These approaches, in one way or another, seek an alternative to the current inter-state conceptual system (Vattelien arrangement), and are opposed to the existence of a political unity that will take the ideal form of a "world state".

These cosmopolitan trends can be traced, at least in part, to the work of Immanuel Kant and his 1795 essay 'Perpetual Peace'<sup>144</sup>. It is remarkable that Kant, who never left his hometown of Königsberg (present day Kaliningrad) in the 18th century, is now an inspiration for current global cosmopolitan and liberal ideas<sup>145</sup>.

Kant's 'Perpetual Peace' is structured in two sections containing six 'Preliminary' and three 'Definitive' articles for achieving such peace. The text is characterized by a degree of ambiguity that allows each reader to interpret it according to his conceptual preferences. There is no clear understanding as to why Kant chose to develop his essay using the aforementioned articles nor regarding his division between preliminary and definitive articles. As Fernando Tesón remarks,

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<sup>143</sup> Dunoff.

<sup>144</sup> Immanuel Kant, *Kant's Perpetual Peace a Philosophical Proposal* (Sweet & Maxwell, 1927).

<sup>145</sup> Fernando R. Tesón, "The Kantian Theory of International Law" (1992) 92 *Columbia Law Review*.; Patrick Capps and Julian Rivers, "Kant's Concept of International Law" (2010) 16 *Legal Theory*; Michael W. Doyle, "Kant, Liberal Legacies, and Foreign Affairs" (1983) 12 *Philosophy & Public Affairs*; James Lindley Wilson and Jonathan Monten, "Does Kant Justify Liberal Intervention?" (2011) 73 *University of Notre Dame, The Review of Politics*; Garrett Wallace Brown, "Moving from Cosmopolitan Legal Theory to Legal Practice: Models of Cosmopolitan Law" (2008) 28 *Legal Studies*.

readers and commentators who focus on the role of the state, such as realists<sup>146</sup> who are concerned with international relations, pay more attention to the preliminary articles. On the other hand, readers who have adopted cosmopolitan or political liberal stances tend to focus on the definitive articles.

There are three ‘definitive articles for perpetual peace among states’. The first one — ‘the civil constitution of every state is to be republican’ — deals with the type of state that is needed, i.e. a Republic, for achieving perpetual peace. It is not a surprise that supporters of liberal democracies embrace the republic as the Kantian version for the organization of states, and even see the postulate of this article as a motivation for spreading liberal principles among nations,<sup>147</sup> something that Kant probably did not have in mind.<sup>148</sup>

The second article — ‘the Law of Nations is to be founded on a Federation of Free States’ — develops the idea of a league, which Kant proposed be called a league of peace, that, at the same time, would not amount to a concentration of power as in the state:

So there must be a special sort of league that can be called a league of peace (focdus pacificum), aiming to make an end to all wars forever, to be distinguished from a treaty of peace (pactum pacis) which only ends one war [...] The league of peace would not be concerned with the acquisition of power by any state [...] <sup>149</sup>

Therefore, the proposal of Kant involves the organization of states in order to abstract them from the ‘state of nature’ just as at the domestic level, but without creating a new sovereignty among states. This idea resembles the proposition of governance without government that has also been developed under the rubric of new governance approaches within this century.

The third article — ‘world citizenship is to be united to conditions of universal hospitality’ — explains the right of a visiting foreigner not to be treated as

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<sup>146</sup> Tesón 58

<sup>147</sup> For a liberal reading of Kant, see: Doyle.

<sup>148</sup> As noted in Wilson.

<sup>149</sup> Kant.

an enemy<sup>150</sup>. The basis for Kant's hospitality is a claim that "no one had more right than another to be in any one particular place"<sup>151</sup>, and this article established the premises to approach the idea of a constitution of 'world citizenship', or 'cosmopolitan constitution'.

These three short definitive articles were written in the same century as Vattel's *Law of Nations*, and yet contested the latter. Whereas the Vattelian setting saw the law of nations only in the agreements between states, the *patres familias* representatives of their people, the ideal Kantian setting set forth clear ideas for the justifiability of the exercise of authority. First, states needed to be organized or constituted as republics (Definitive Article I), a concept equivalent to what today can be termed liberal democracies. Second, these types of states should associate in a form of alliance with the sole function of achieving peaceful coexistence (Definitive Article II) and without the concentration of power in a new world sovereign entity to avoid the imminent danger of creating a world tyrant. Finally, and under these conditions, humankind could seek the development of a cosmopolitan constitution (Definitive Article III) or world citizenship constitution, where universal rights could be assured. The Kant proposition attacks the idea of exclusive public authority from within the state and from the outside.

Therefore, the cosmopolitanism ideas linked to Kant regain importance again in the current period, because these fundamental ideas could be used for any actor that is not a state to promote a specific agenda, outside the strong version of inter-state law based on consent. In other words, a great majority of thinkers became cosmopolitans —following Kant or his postulates— either to promote liberalism, human rights or other agendas.

Nowadays, the term cosmopolitanism implies individualism, universality and generality<sup>152</sup>: First, individualism, because the ultimate concern is the human being rather than communities, nations, or states<sup>153</sup>; second, universality as the

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<sup>150</sup> *ibid* 33

<sup>151</sup> *ibid*

<sup>152</sup> Thomas W. Pogge, "Cosmopolitanism and Sovereignty" (1992) 103 *Ethics* 48.

<sup>153</sup> *ibid*.



scope of concern is every living human being<sup>154</sup>; and finally, generality because human beings are the concern of everyone<sup>155</sup>.

These characteristics can be externalized, according to Thomas W. Pogge, in either a moral or a legal cosmopolitanism. Legal cosmopolitanism implies a commitment to the ideal of a global order for equal rights and duties for everyone<sup>156</sup>, while moral cosmopolitanism holds that all persons stand in certain moral relations to one another.<sup>157</sup> Therefore, the cosmopolitan stances have the risk of becoming too ideal or too vague, if they are not spelled out in a more concrete definition.

The shortcoming of cosmopolitan ideas is the risk of missing dynamics that are being produced by fragments of society, with their norms generating power. In addition, the use of universal and general stances involves intrinsic danger that cannot be overlooked.

### 2.3.5 Global Governance Trends

A number of other notable conceptual enterprises can be grouped under the category of Global Governance or New Governance trends<sup>158</sup>. In many of these attempts, we can still see the influence of Kant, although sometimes this is not explicitly recognized by its authors. The use of these terms can be traced back to international relations scholar James Rosenau's 'Governance without Government' published in 1992.<sup>159</sup>

The concept of governance without government clarifies the relation between order and governance—as distinguished from the simple absence of government<sup>160</sup> which equates with anarchy. For Rosenau, governance is a 'system

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<sup>154</sup> *ibid* 48-49.

<sup>155</sup> *ibid* 49

<sup>156</sup> *ibid*.

<sup>157</sup> *ibid*.

<sup>158</sup> Karsten Nowrot, "Global Governance and International Law", (2004) 33 *Beiträge zum Transnationalen Wirtschaftsrecht* 5-10

<sup>159</sup> James N Rosenau and Ernst-Otto Czempiel, *Governance without Government: Order and Change in World Politics* (Cambridge Univ. Press 1992).

<sup>160</sup> Thomas G. Weiss, "The Un's Role in Global Governance, Briefing Note N.15", (2009) *UN Intellectual History Project*.

of rule that works only if it is accepted by the majority'<sup>161</sup>, whilst government can function even in the face of opposition. The idea of Global Governance is further developed in the creation and later report of a Commission of Global Governance founded under the initiative of Willy Brandt, a former German Chancellor.<sup>162</sup>

The term Global Governance was later used in the European context, in a 2001 report of the Commission known as a 'white paper', where it was stated that many people were losing confidence in a poorly understood system and at the same time demanding the right to seize the opportunities offered by globalization<sup>163</sup>. The document stated that the European Union should seek to apply the principles of good governance to its global responsibilities<sup>164</sup>.

From this point on, different research agendas started to gain ground. This included scholars focused on the relation between International and Global Governance,<sup>165</sup> as well as the emergence of projects like Global Administrative Law (GAL) which began to gain more visibility. GAL sees global governance as administration<sup>166</sup> where many administrative and regulatory functions are performed in a global—rather than national—context. The literature of GAL starts to use the word legitimacy along with global governance. Kirsch and Kingsbury, in their opening statement on Global Governance and GAL, used the word in the following way:

Yet central pillars of the international legal order are seen from a classical perspective as increasingly challenged: the distinction between domestic and international law becomes more precarious, soft forms of rulemaking are ever more widespread, the

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<sup>161</sup> Rosenau and Czempiel (n 160) 4.

<sup>162</sup> See references to this commission in: Weiss, Nowrot.

<sup>163</sup> See, "European Governance: A White Paper" (COMMISSION (2001/C 287/01), 2001).

<sup>164</sup> Ibid.

<sup>165</sup> See: Nowrot (n 159).

<sup>166</sup> Nico Krisch and Benedict Kingsbury, "Introduction: Global Governance and Global Administrative Law in the International Legal Order" (2006) 17 *European Journal of International Law* 3.

sovereign equality of states is gradually undermined, and the basis of legitimacy of international law is increasingly in doubt.<sup>167</sup>

The use of the word 'legitimacy'<sup>168</sup> is not casual; indeed, it is used several times but most of the authors relate it to GAL. However, the idea of Global Governance was not new and can, in fact, also be understood as an evolution of cosmopolitan trends. The use of the word legitimacy in this context would signal the intention to undermine the state consent paradigm as a source of normativity on the international level. In other words, there is no such thing as a treaty that establishes what principles of administrative law should apply under international law. Therefore, when GAL scholars talk about legitimacy they contest the Vattelien model- or at least try to exist alongside it.

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<sup>167</sup> *ibid* 1.

<sup>168</sup> Ingo Take, "Legitimacy in Global Governance: International, Transnational and Private Institutions Compared" (2012) 18 *Swiss Political Science Review*.

### ***3. International Investment Law from the Standpoint of Global Legal Pluralism***<sup>169</sup>

The development of an investment treaties regime cannot be seen as an isolated phenomenon. International norm-creating processes are part of a wider phenomenon, i.e. the expansion of norm generation processes outside of nation-states encompasses almost all aspects of human activity. It is also necessary to draw attention to this chaotic picture of the global legal setting in its entirety so as to understand that disputes in international investment law are only one facet of a much wider question.

Thinking about normative disputes in the context of international law is usually framed by the concepts of validity and hierarchy. Validity refers to the application of the sources expressed in Article 38 of the Statute of the International Court of Justice (ICJ). This article is believed to recognise a system of sources for international law<sup>170</sup> in a way that resembles the ‘secondary’ rules of national law systems, because in the absence of a global legislator, this article reflects the criteria of legal validity for international law.<sup>171</sup> On the other hand, hierarchy implies that in the case of a conflict between two valid norms, one must prevail.

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<sup>169</sup> A part of the research contained in the present chapter (first part of section 3.1 and 3.3.3) was included in the peer reviewed chapter: José Gustavo Prieto Muñoz, "International Investment Disputes in South America: Rethinking Legitimacy in the Context of Global Pluralism", in Attila Tanzi, et al. (eds.), *International Investment Law in Latin America: Problems and Prospects / Derecho Internacional de las Inversiones en América Latina: Problemas y Perspectivas* 2016). Journal of World Investment & Trade, in the article ‘The Rise of Common Principles for Investment in Latin America: Proposing a Methodological Shift for Investor-State Dispute Settlement’.

<sup>170</sup> See, in this sense, an analysis of the application of HLA Hart theory to the international system in Harlan Grant Cohen, "Our Fragmenting Legal Community. (Finding International Law, Part 2)", (2012) 44 *New York University Journal of International Law and Politics (JILP)* 1049.

<sup>171</sup> Herbert L. A. Hart, *The Concept of Law* (Clarendon Press 1961) 85.

In the case of international law, the question of validity will then depend on the ‘pedigree’ of the traditional sources of international law.<sup>172</sup> However, this approach to dealing with the expansion of norms and adjudicative bodies does not help us to fully understand developments and issues in international investment law because it only examines the production of legal norms by the state and misses the transnational dimension inherent in many areas including foreign investment. The case of international investment law implies a normative regime that is shaped by states using treaties, but there is also normative production by autonomous fragments of global society. These fragments have added criteria for validity beyond Article 38, which will be discussed below.

An additional perspective is needed to analyse the transnational component of international investment law. If we see the current global setting only through the lens of Article 38 of the Statue of the ICJ, whatever we analyze will look like customs, treaties, or general principles. For exactly this reason, because international investment law cannot exist in an ‘intellectual vacuum’,<sup>173</sup> this theoretical concern was already recognised as a weakness in the early years of the discipline.<sup>174</sup> It is clearly necessary to find a different perspective, using maps to highlight special issues that were previously ignored.<sup>175</sup> Consequently, a full understanding of international investment law cannot emerge from within the borders of the network of treaties and awards, but rather requires an examination of the structure of global society.

The present chapter argues that the conceptual standpoint of global pluralism can help us better understand such dynamics because it highlights the idea of the coexistence of norms at different levels: national, international and transnational. For this reason, it may be useful to capture the current state of the

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<sup>172</sup> Simma Bruno et al., "Symposium on Method in International Law: The Responsibility of Individuals for Human Rights Abuses in Internal Conflicts: A Positivist View" (1999) 93 *American Journal of International Law* 305.

<sup>173</sup> See Ian Scobbie in Malcolm D. Evans, *International Law* (Univ. Press 2006) 59.

<sup>174</sup> Stephan W. Schill, *International Investment Law and Comparative Public Law* (Oxford Univ. Press 2010) 3.

<sup>175</sup> Evans 60.

debate on globalisation and international investment law. It will further be claimed that from this perspective, the international investment law regime is composed of two dimensions: normative and transnational. The first one is composed of norms, embodied in International Investment Agreements, while the second one represents the development of norms within transnational sources, i.e. arbitral decisions and investment contracts, where the responsibility of states is established.

### ***3.1 Conceptual Notes on Global Legal Pluralism***

The term ‘pluralism’ has emerged in the legal debate in the last years, but this conception may include a widely diverse set of understandings as to what ‘legal pluralism’ and ‘global legal pluralism’ mean; thus, one should be careful when using these terms, especially because in recent years, scholars from different legal areas have addressed the phenomenon in different ways.

The first distinction involves the word ‘pluralism’ and the differentiation of at least three types of concepts that this word may represent: cultural, political, and legal. Cultural pluralism implies the coexistence of different common identities, while political pluralism expresses the idea of the coexistence of factions or interest groups inside a political system. On the other hand, legal or normative pluralism in a broad sense refers to a situation in which ‘two or more laws (or legal systems) coexist in (or are obeyed by) one social field’<sup>176</sup>. Legal pluralism will be the concept developed in this work.

With this broad definition, it is possible to draw a distinction between two associated but different ideas of legal pluralism. The first one is the traditional legal pluralism that has been studied in anthropology and sociology of law which analyses overlapping normative orders and is concerned only with the interplay of Western and non-Western laws in colonial and postcolonial settings.<sup>177</sup> The second idea is a global legal pluralism that sees the overlap of normative orders not only

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<sup>176</sup> Ralf Michaels, "Global Legal Pluralism" (2009) 5 *Annual Review of Law and Social Science* 243-245; see also Jan Klabbers, *Normative Pluralism and International Law Exploring Global Governance* (Cambridge Univ. Press 2013).

<sup>177</sup> Michaels 245.

by geographical criteria, but also according to sectorial criteria, such as the concepts stemming from studies on globalisation and trans-nationality.

The idea of global pluralism has been approached from two sides. On the one hand, there is a three-step evolution process in the traditional legal pluralism doctrine. The first perspective on legal pluralism referred to the existence of parallel legal orders after colonisation under the territorial authority of a state<sup>178</sup>, while a later perspective on pluralism recognised the coexistence of legal systems also in the so-called 'Western States', with an acknowledgement that the pluralist phenomenon was not confined to colonies.<sup>179</sup> The last step was to arrive at a global legal pluralism that involves trans-nationality.<sup>180</sup> On the other hand, globalisation scholars and theorists approach global legal pluralism with an interest in its legal structures and institutions rather than in the communities that created them.<sup>181</sup>

These two evolutionary paths both arrived at the concept of the coexistence of legal systems in three dimensions: the internal (traditional pluralism), the external and the transnational dimensions. The concept of global legal pluralism therefore implies a response to globalisation whereby multiple assertions of legal authority exist over the same act.<sup>182</sup> However, among these dimensions, the transnational one is perhaps the most controversial because it implies abandoning the idea of the state as the sole lawmaker, as well as the concept of territorially-based authority<sup>183</sup> which was the base of the Vattelien arrangement for international law. This form of legal pluralism carries with it the risk of tensions and conflicts

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<sup>178</sup> See, Daniel Fitzpatrick, "Disputes and Pluralism in Modern Indonesian Land Law ", (1997) 22 *Yale Journal of International Law* 170.; June Prill-Brett, "Indigenous Land Rights and Legal Pluralism among Philippine Highlanders", (1994) 28 *Law & Society Review*.

<sup>179</sup> Michaels (n 177) 247.

<sup>180</sup> Ibid. For examples of Global Legal pluralism in this context see: Oren Perez, "Normative Creativity and Global Legal Pluralism: Reflections on the Democratic Critique of Transnational Law" (2003) 10 *Indiana Journal of Global Legal Studies*.

<sup>181</sup> Michaels 248. For a vision of global pluralism from a constitutionalist perspective see Alec Stone Sweet, "Constitutionalism, Legal Pluralism, and International Regimes" (2009) 16 *Indiana Journal of Global Legal Studies*.

<sup>182</sup> Paaul Schiff Berman, "Global Legal Pluralism" (2007) 80 *Southern California Review* 1159–60.

<sup>183</sup> *ibid* 1161.

where overlapping legal authorities<sup>184</sup> exist, for example when both an international investment and a human rights adjudicator exercise authority over the same facts.

From this perspective, global society may be seen as working through sectorial interdependences that can generate conflicts whose origin lies not only in the encounter of diverse countries, but also in the collision between distinct global social sectors.<sup>185</sup> The relationship between sectors is the core of the transnational element, as the latter goes beyond the nation-state and lies in the creation of hybrid spaces. The international investment law regime was built on a system of bilateral international treaties, but the conceptually connected decisions of investment adjudicators have extended part of its substantive rules to a hybrid dynamic.

These sectorial interdependencies within the current global society represent a break from the traditional conception of international law because they entail not only the collision of norms but also the collision of legitimacies and legal discourses. In other words, the tensions that can be seen in disciplines like international investment law cannot be considered only as a problem of interpretation. Taking this into account, the existence of these global sectors - generating the current inter-systemic conflicts- demands a space of coexistence, a space for “legitimate difference”,<sup>186</sup> which has already been created through the inter-systemic and “inter-judicial dialogue”<sup>187</sup> between adjudicators in other fields of law, and is starting to take place in international investment law as well.

Finally, the choice of global pluralism and the interest in the normative production of communities as a conceptual base for the present work acknowledges the possibility of normativity beyond the state and inter-state systems, though that does not imply a defence for law without the state, such as that which a radical pluralist point of view would provide. The difference appears subtle, but it has

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<sup>184</sup> *ibid* 1163.

<sup>185</sup> Andreas Fischer-Lescano and Gunther Teubner, "Regime-Collisions: The Vain Search for Legal Unity in the Fragmentation of Global Law" (2004) 25:999 *Michigan Journal of International Law* 1000.

<sup>186</sup> William W. Burke-White, "International Legal Pluralism" (2004) 25 *Michigan Journal of International Law* 979.

<sup>187</sup> For a discussion of inter-judicial dialogue see: *ibid* 971–73.



considerable implications: in the end, any type of normative production outside state borders comes into contact with a national legal system, especially in terms of its execution.

For the aforementioned arguments, the advance in this conceptual stance also implies some conceptual and terminological rigor because, as has been shown, a word not only carries its history, but also a structure. In this case, we need to clarify three concepts for a pluralistic understanding of international investment law, mainly: authority, normative order, and communities.

### **3.1.1 Authority**

The term authority has been defined by Rodney Bruce Hall and Thomas Biersteker as ‘institutionalized forms or expressions of power’<sup>188</sup>. If authority is the institutionalized expression of power, it represents a degree of evolution from the mere use of force as domination. However, the definition needs clarification regarding the characteristics of what is understood as institutionalization.

Kelsen also distinguished power from authority, where power can be defined as the capacity ‘of forcing others to a certain behavior’,<sup>189</sup> and, according to him, this capacity does not suffice to constitute authority. Kelsen later connects the need for a link between the origins of this capacity (power) and a normative order. This characteristic allows one to better redefine the idea of institutionalization of power in Barnett’s definition. Only a normative order can produce authority; therefore, it is different from plain power obtained by physical force. However, Kelsen’s conception of authority is included in his coherent hierarchical vision of law. According to him, only a sovereign—state can exercise authority. He states:

Authority is thus originally the characteristic of a normative order. [...] only a normative order can be ‘sovereign’ that is to say, a supreme authority, the ultimate

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<sup>188</sup>Rodney Bruce Hall and Thomas Biersteker, quoted by Alan Brouder, in Christian Tietje, *Handbook of Transnational Economic Governance Regimes* (Martinus Nijhoff Publishers, 2009).

<sup>189</sup> Kelsen (n 82) 582.

reason for the validity of norms which one individual is authorized to issue as commands and other individuals are obliged to obey<sup>190</sup>

However, if the existence of a plurality of normative orders is acknowledged, there is also the possibility for a plurality of public authorities. In the context of plurality, Bogdandy adopts the following definition of authority as: 'legally grounded capacity to actually, or legally, restrict the freedom of other actors or otherwise determine how they use their freedom'<sup>191</sup>. The first part of the definition is similar to Kelsen's in that the origin of authority must come from a normative order. In addition, the definition encompasses both 'obligatory legal acts'<sup>192</sup>, understood as acts that modify the legal situation of a subject, and 'non-binding acts'<sup>193</sup> of International Organizations. The latter can be explained when such non-binding acts exercise a pressure that can be withstood only with a 'degree of difficulty'<sup>194</sup>. This wider conception of authority includes and explains the effects of acts that traditionally have been termed 'soft law'<sup>195</sup>.

Finally, in order to justify this capacity in the context of plurality, authority can be non-exclusive, implying the possibility of several overlapping and interacting authorities that co-exist. Rughan uses the term 'relative authority' to describe this situation. Two types of relative authority can be distinguished: same-domain plurality, where there are two or more authorities in the same domain, and interactive-domain plurality, where authorities with separate domains interact with one another.<sup>196</sup> The existence of relative authority can only be justified in its

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<sup>190</sup> Ibid.

<sup>191</sup> Armin von Bogdandy, "Common Principles for a Plurality of Orders: A Study on Public Authority in the European Legal Area" (2014) 12 *International Journal of Constitutional Law* 987.

<sup>192</sup> Ibid.

<sup>193</sup> Ibid 988.

<sup>194</sup> Ibid.

<sup>195</sup> For a detailed application of this wider concept of authority see: Matthias Goldmann, "We Need to Cut Off the Head of the King: Past, Present, and Future Approaches to International Soft Law" (2012) 25 *Leiden Journal of International Law*.

<sup>196</sup> Nicole Roughan, "The Relative Authority of Law: A Contribution to 'Pluralist Jurisprudence'", in Maksymilian Del Mar (ed.), *New Waves in Philosophy of Law* (Palgrave MacMillan 2011) 258.

relationship—which includes cooperation and coordination, toleration, and conflict<sup>197</sup>—with other authorities.

### **3.1.2 Normative Orders, Systems and Regimes**

If the definitive element that distinguishes power from authority is its legal character, then the definition of normative order also becomes relevant. The word ‘order’ can be understood as a body of rules to regulate or conduct behavior, or as ‘shared expectations governing a particular social situation’<sup>198</sup>. For Kelsen, the function of an order, social in the case of law, was to induce men to ‘refrain from certain acts which for one reason or another are deemed detrimental to society and to perform others which for one reason or another are regarded as useful to society’<sup>199</sup>. Along this line of thought, law as a coercive order implied the use of sanction, and that element differentiates it from other types of orders —such as religious and moral orders— which are based on voluntary obedience. This idea of order is linked with the vertical concept of law developed by Austin that was left behind by later positivist accounts, such as that of Hart.

In any case, the general definition of ‘order’ that can be established away from that vertical idea of order as a ‘set of rules’ can be a starting point. However, there is a need for a clearer definition of the concepts and structures of such rules. In this sense, distinguishing between a regime and system can prove useful.

The International Law Commission (ILC) refers to ‘regime’ and ‘self-contained regime’ as equivalents for ‘rule-complex’ or ‘new and special types of law’<sup>200</sup> that seek to respond to new technical and functional requirements. From the report, it can be established that each regime is characterized by its own principles, expertise and its own ethos,<sup>201</sup> with the claim of its binding force made by the relevant actors to be covered.<sup>202</sup>

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<sup>197</sup> *ibid* 259.

<sup>198</sup> Scott John and Marshall Gordon, "Normative Order" (Oxford University Press 2009).

<sup>199</sup> Hans Kelsen, *Principles of International Law*, (Holt 1967).

<sup>200</sup> Commission para 10

<sup>201</sup> *ibid*.

<sup>202</sup> *Ibid* para 12.

The ILC fragmentation report refers to three types of regimes. First, where the violation of a ‘particular group of (primary) rules is accompanied by a special set of (secondary) rules concerning breach and reactions to breach’<sup>203</sup>. Second, regimes where there are special rules relating to a particular subject matter, and finally, rules and principles that regulate a certain problem area.<sup>204</sup> The term ‘regime’ used by ILC must be understood in the context of the main conclusion of the report: ‘International law is a legal system’<sup>205</sup>; therefore, a regime must come from state consent. In this case, the reference to principles in the third type of self-contained regime can only be understood in the light of article 38(c) of the ICJ Statute.

The ILC report includes neither the normative production nor forms of authority that are outside of the state consent in its definition of regime. However, it is useful to recall the logical distinction that is made between the concepts of ‘regime’ and ‘system’. In the logic of the report, a system (international law) can be composed of several regimes; therefore, the differentiating element for a system is the existence of ‘meaningful relationships’ between rules expressed on a hierarchical level<sup>206</sup>.

The word ‘regime’ has also been used in international relations theory. Specifically, the definition of regime by Stephen Krasner has been widely used by international law scholars. Krasner defines the concept in the following way:

Sets of implicit or explicit principles, norms, rules, and decision-making procedures around which actors’ expectations converge in a given area of international relations. Principles are beliefs of fact, causation, and rectitude. Norms are standards of behavior defined in terms of rights and obligations. Rules are specific prescriptions or proscriptions for action. Decision-making procedures are prevailing practices for making and implementing collective choice.<sup>207</sup>

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<sup>203</sup> *ibid* para 14 (3).

<sup>204</sup> *ibid*.

<sup>205</sup> *ibid* para 14 (1).

<sup>206</sup> *ibid*.

<sup>207</sup> Stephen D. Krasner, *International Regimes* (Cornell Univ. Pr. 1983). Also used in Tietje 30-31

Krasner's definition was originally thought to apply to relations between states, but several authors have used this concept because it can also be adapted for normative production by fragments of society on a transnational dimension. However, the concepts expressed in the definition do not allow us to distinguish between certain elements such as between values and principles.

In light of the descriptions provided, it can be concluded that while a regime involves the production of norms, such as rules and principles, with some coherence between them, a system implies a larger structure of hierarchy between those rules. In that case, it is possible to speak of transnational regimes to describe systems of rules that have not achieved a full hierarchical structure.

If this conceptual understanding is accepted, it is still necessary to clarify when a set of norms has enough coherence to be considered a regime in the first place. In this case, the distinction between rules of the first and second type made by H.L. Hart can help as a measure of the complexity of a set of norms. To make a distinction between primary and secondary rules, he stated:

While primary rules are concerned with the actions that individuals must or must not do, these secondary rules are all concerned with the primary rules themselves. They specify the ways in which the primary rules may be conclusively ascertained, introduced, eliminated varied, and the fact of their violation conclusively determined<sup>208</sup>

On this basis, one criterion that can help to differentiate a group of rules from a legal regime is the existence of special criteria of validity that allow norms to be internalized by a regime. The absence of secondary rules that determine the content of the primary rules is what allows Hart to refer to a system as 'primitive'. International law, according to Hart's analysis, did not have those secondary rules. Later, several authors<sup>209</sup>, including Franck in his work on legitimacy, adopted

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<sup>208</sup> Hart and Bulloch (n 26) 94

<sup>209</sup> See Cohen, Harlan Grant Cohen, "From International Law to International Conflicts of Law: The Fragmentation of Legitimacy" (2010) 104 *Proceedings of the Annual Meeting (American Society of International Law)*

Hart's distinction between primary and secondary rules but argued that international law does possess secondary rules though in a different form from those of national systems.

If this criterion is incorporated in transnational dynamics, a normative order can also arise when fragments of society have developed criteria of validity, a type of 'rules of recognition' or loose? 'secondary rules' within or beyond the national and international systems. Therefore, conflicts on the current global setting can result not only from overlapping authorities but also from the use of overlapping criteria of normative validity.

### 3.1.3 Communities

States are not the only actors in the global legal setting: individuals and corporations have also been active in recent decades directly accessing international adjudicative bodies. In addition, the present work argues for the inclusion of the analysis of non-territorially-based sectors of global society that shape rules and generate types of authority that can coexist and sometimes compete with the authority of states. In this scenario, it is also important to clarify the terminology used. First, one needs to distinguish between society and community. Schwarzenberger provides a clear distinction between these concepts, defining community as a 'social group in which behavior is based on the solidarity of members, a cohesive force without which the community cannot exist'<sup>210</sup>. On the other hand, society can be understood as a social group that coexists in a system that provides 'adjustment of diverging interests'<sup>211</sup>. Therefore, society is a broader term and a society can be composed of a multiplicity of communities such that a single person could possibly be a member of several communities but is usually a member of just one society.

The term community was also studied in the context of states by Karl Deutsch (1912–1992) who developed the idea of 'security communities' to describe the pluralistic formation of states that become integrated with a 'sense of community', which in turn creates the assurance that disputes will be settled without

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<sup>210</sup> Georg Schwarzenberger, "The Rule of Law and the Disintegration of the International Society" (1939) 33 *The American Journal of International Law*.

<sup>211</sup> *ibid*

war<sup>212</sup>. However, Deutsch's 'sense of community' can be assimilated by Swazenberg's idea of 'solidarity' for the purpose of this analysis. It is notable that Swazenberg draws this distinction in a 1936 article analyzing the term community in the context of states, when a Vattelian arrangement was intact, and did not aim to describe transnational communities. However, his definition allows for a distinction from the concept of society prevalent today.

The transversal social dynamics that operate in forms of communities outside the territory of the state borders have generated a conceptual and terminological puzzle for international lawyers and scholars. In order to solve this riddle, there have been a series of terms imported into the legal debate to describe communities formed by such transversal dynamics, for instance: legal, transnational, epistemic, scientific, and normative dynamics.

Some authors incorporate the term 'legal communities' and 'communities of practice' in their analyses. The latter term was taken from the international relations scholar Emanuel Adler<sup>213</sup> who defines communities of practice as:

People who are informally as well as contextually bound by a shared interest in learning and applying a common practice. (...) Such a common practice, "in turn, [is] sustained by a repertoire of communal resources, such as routines, words, tools, ways of doing things, stories, symbols, and discourse"<sup>214</sup>

Another term that has been incorporated into the debate<sup>215</sup> is 'epistemic communities' which originally was used as an equivalent to 'scientific

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<sup>212</sup> For a discussion of the concept of "Security communities" see Emanuel Adler, *Security Communities* (Cambridge University Press 1998) 3-9.

<sup>213</sup> Adler has also used the term "*security communities*" used earlier by Karl Deutsch in the context of states.

<sup>214</sup> Emanuel Adler, *Communitarian International Relations: The Epistemic Foundations of International Relations*, quoted in Cohen 1064-1065.

<sup>215</sup> See the use of the term in Alex Mills, "Antinomies of Public and Private at the Foundations of International Investment Law and Arbitration" (2011) 14 *Journal of International Economic Law*.

communities' to refer to groups of professionals specifically in natural science,<sup>216</sup> but in 1992, Peter Hass, also an International Relations scholar, used it in an expanded context:

An epistemic community is a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area [...] they have (1) a shared set of normative and principled beliefs [...] (2) shared causal beliefs, (3) shared notions of validity- that is, intersubjective, internally defined criteria for weighing and validating knowledge in the domain of their expertise; and (4) a common policy enterprise-that is, a set of common practices associated with a set of problems to which their professional competence is directed [...]<sup>217</sup>

The German legal scholar Günther Teubner has advanced a concept of transnational communities in the following terms:

Transnational communities, or autonomous fragments of society, such as the globalized economy, science, technology, the mass media, medicine, education and transportation, are developing an enormous demand for regulating norms which cannot, however, be satisfied by national or international institutions. Instead, such autonomous societal fragments satisfy their own demands through a direct recourse to law. Increasingly, global private regimes are creating their own substantive law. They have recourse to their own sources of law, which lie outside spheres of national law-making and international treaties.<sup>218</sup>

The transnational communities concept of Teubner, refers to 'fragments of society', which can be grouped together as a community cohesive enough to self-operate. He adds the element of the need for a normativity that is not satisfied under

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<sup>216</sup> Peter M. Haas, "Introduction: Epistemic Communities and International Policy Coordination" (1992) 46 *International Organization, Knowledge, Power, and International Policy Coordination* (Winter). See footnote 4 at p 2

<sup>217</sup> *ibid.*

<sup>218</sup> Fischer-Lescano and Teubner 1010



the state or inter-state system, and the further production of ‘transnational legal regimes’ that are functionally differentiated rather than territorially<sup>219</sup>. Adopting Teubner’s terminology is useful; however, we should clarify that most of his theory is based on an evolution of Niklas Luhmann’s system theory,<sup>220</sup> where the individual as a concern can get lost in the analysis, therefore the incorporation of this definition is not a blind addition to Teubner’s system theory.

In order to avoid linguistic and conceptual confusion, two concepts of communities will be used in the present work: transnational communities and epistemic communities. The first one is shaped along the lines sketched by Teubner, and is compared to the idea of a normative order, explained later (see section 1.3 b). In this case, a transnational community implies: an autonomous —self-directed—fragment of society, with solidarity as a cohesive force, that has developed or is in the process of developing a set of rules of recognition, or criteria of normative validity, within or beyond the nation state or the international legal system.

In addition, the concept of epistemic communities taken from Peter Hass will be used to differentiate an autonomous fragment of society from a network of professionals that may be related to several transnational communities. This allows us to distinguish between transnational communities engaged in economic transactions and the epistemic arbitration community that is developing the international investment regime.

The distinction is not a minor one because it hides a degree of complexity in the current legal setting. Global society has become so complex that there are several transnational communities engaged in different economic activities in need of normativity at the global level. So, the need for normativity has determined the development of regimes that can be shaped by a community of professionals —an epistemic community.

The idea of a global or world society can further be analyzed<sup>221</sup> at a level where all transnational and epistemic communities are integrated. However, it is far

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<sup>219</sup> Ibid.

<sup>220</sup> Mainly see, Niklas Luhmann, *Law as a Social System* (Oxford Univ. Press 2004).

<sup>221</sup> See Ian Clark, *International Legitimacy and World Society* (Oxford University Press 2007).

beyond the focus of this work to study the existence (or non-existence) of such an entity. The only aim in the distinction of these two types of communities is to better understand normative developments in the field of foreign investment.

The dynamics of the International Investment Law regime cannot be analyzed only from the inter-state logic of norm generation processes. This means that additional ‘secondary rules’ on H-L. Hart terms —norms that allow other rules to be introduced to a legal system or regime— are shaping the regime. These dynamics lead us to distinguish the International Investment Law as a regime that has developed some coherence through the use of these types of ‘secondary rules’ and ‘decision-making procedures’<sup>222</sup>.

### ***3.2 The Normative Dimension of the International Investment Regime***

The investment regime is composed of two dimensions. The first —a normative one—constituted by the chaotic network that already had more than 3,268 International Investment Agreements (IIAs) by the end of 2015, of which 2,923 were bilateral investment treaties (BITs)<sup>223</sup>. Despite the great number of these types of treaties, they share a common structure composed of substantive rules and clauses introducing international arbitration as a means to solve disputes. In addition, there is a second dimension of the regime —a transnational one— that relies primarily on the decisions of a universe of state-investor disputes, and on the incorporation of investment contracts. There are already more than 700 known investor-state cases<sup>224</sup>, and more than 200 awards, that have developed a type of jurisprudence taken into consideration by new tribunals in future cases.

Despite the high number of cases, there is only a single group of arbitrators that actually decides these disputes, which means that a considerable number of

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<sup>222</sup> Jeswald Salacuse applies regime theory to his study of investment treaties, where he defines decision-making procedures as ‘prevailing practices for making and implementing collective choice’, see Jeswald W. Salacuse, *The Law of Investment Treaties* (Oxford Univ. Press 2010) 10-11.

<sup>223</sup> UNCTAD United Nations Conference on Trade And Development, "IIA 2015 Issues Note No.1: Recent Trends in IIAS and ISDS" 2015, 2.

<sup>224</sup> UNCTAD United Nations Conference On Trade And Development "IIA 2015 Issues Note No 2: Investor-State Dispute Settlement: Review of Developments in 2014", 2015.

arbitrators are appointed several times.<sup>225</sup>In this context, lawyers, arbitrators and scholars specializing in investment constitute the International Investment Arbitration community<sup>226</sup>. However, this does not imply that the whole investment regime is based on the decisions of this group of people, because this so-called Investment Arbitration Community is only the visible part of a series of networks, ensembles, and other forms of global interactions involving cross-border transactions. This has promoted the creation of values, norms and principles that have been adopted from two epistemic communities: public international and international commercial lawyers.<sup>227</sup>

The next two sections explain how the dynamics between these two dimensions—normative and transnational— of the international investment regime have created a type of authority outside the state level. It also explains how the regime has generated its own understanding of the three topics that have been covered by the word ‘legitimacy’: criteria of validity (legal legitimacy), acceptance (sociological legitimacy), and values for justifiability (moral legitimacy). Therefore, the conflicts that have arisen from the use of investment arbitration are conflicts not only of norms or interpretation of those norms, but also conflicts between global sectors of societies, and the forms of authorities created by them.

The principal source of what is referred to as international investment law is the universe of more than 3,200 International Investment Agreements. The first agreement of this kind was the bilateral investment treaty (BIT) between Germany and Pakistan on November 25, 1959<sup>228</sup>. This was followed by a second treaty signed on December 16th of the same year between Germany and the Dominican Republic. Over the next years, several European countries began negotiating similar treaties,

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<sup>225</sup> See Pia Eberhardt and Cecilia Olivet, *Profiting from Injustice* (Corporate Europe Observatory and the Transnational Institute 2012).

<sup>226</sup> Moshe Hirsch, "The Sociology of International Investment Law Available at SSRN: <http://Ssrn.Com/Abstract=2322328>", in Dr. Shai Dothan (ed.), (International Law Forum of the Hebrew University of Jerusalem Law Faculty 2013) 6.

<sup>227</sup> S. W. Schill, "W(H)ither Fragmentation? On the Literature and Sociology of International Investment Law" (2011) 22 *European Journal of International Law* 888.

<sup>228</sup> Kenneth J. Vandeveld, *Bilateral Investment Treaties : History, Policy, and Interpretation* (Oxford University Press, 2010) 1.

such as the following: France concluded an agreement with Chad in 1960, Switzerland with Tunisia in 1961, The Netherlands also with Tunisia in 1963, Italy with Guinea in 1964, and later a series of other European states followed the same practice<sup>229</sup>.

These types of Investment agreements began to be used after several failures to achieve a multilateral agreement on investment, and represented a more suitable alternative for the protection of investment than other existing types of bilateral agreements such as the Friendship Navigation and Commerce treaties (FCN).

The FCNs were a type of treaty originally used in the 18th and 19th centuries to strengthen alliances between nations, and usually covered a wide range of areas. For this reason, a second generation of FCNs re-emerged after the Second World War. Mainly, there were two types of post-war treaties: one used by the Soviet Union and another by the United States. The Soviet FCNs were characterized by a very broad scope of areas and with a limited development of substantive rules of protection<sup>230</sup>. On the other hand, the United States' post-war FCNs provided a more comprehensive set of substantive rules. However, in the long run, these types of US FCN treaties lost ground against the European BIT programs.

The BITs were preferred to the FCNs for several reasons. First, the scope of FCNs was too wide compared with that of the BITs. The FCNs developed substantive rules, but were focused on a series of other topics besides investment (i.e. trade, navigation rights, human rights) which meant that they were not so easy or quick to negotiate. Further, the focus of the protection was 'property'. By contrast, European BITs contained the same substantive standards of protections as FCN treaties, but the scope was very specific: to protect 'investment'<sup>231</sup>. Second, the FCNs usually used a reference to interstate mechanisms for the solution of disputes by the International Court of Justice. Since the end of the 1960s<sup>232</sup>, BITs started to use arbitration mechanisms from which investors could directly demand compensation for the breach of standards of treatment.

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<sup>229</sup> *ibid* 55.

<sup>230</sup> *ibid* 49.

<sup>231</sup> *ibid* 49.

<sup>232</sup> *ibid* 58.

Consequently, many more BITs were negotiated, even though both types of treaties co-existed for some time. For instance, until 1972, Germany concluded 46 BITs while in the same period the US signed only 2<sup>233</sup>. The US eventually put aside its FCN program to launch its own BIT negotiation program in 1977 during the presidency of Jimmy Carter, but it took time to ratify the new treaties in the US Senate. Finally, in March of 1989, the first USA BIT entered into force with Granada<sup>234</sup> determining the beginning of an active program of negotiation of BITs that shaped the rules of these treaties over the next years.

Despite the fact that the vast majority of BITs have been negotiated, most of them share a common structure of substantive provisions that can be divided into at least three groups of clauses used by states: scope of application provision, specific treatment provisions and general treatment provisions (standards of treatment). The following lines will briefly describe the substantive provisions by giving an overview of these three categories.

### **3.2.1 Scope of Application Clauses**

The first type of provision seeks to determine the scope of application of an International Investment Agreement (IIA) either by defining the definition of the investment, the definition of nationality, or the definition of territory.

#### ***3.2.1.1 Definition of Investment***

The definition of investment is crucial because it determines the scope of application of the whole treaty. There is not a single definition of investment, and the lack of a multilateral agreement has led to a wide variety of definitions emerging in the network of IIAs. The ICSID convention does not contain a definition; it only defines the jurisdiction of the Center of Disputes in the following way:

The jurisdiction of the Centre shall extend to any legal dispute arising directly out of an investment, between a Contracting State (or any constituent subdivision or agency of a Contracting State designated to the Centre by that State) and a national of another

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<sup>233</sup> Kenneth J. Vandevelde, *U.S International Investment Agreements* (Oxford University Press 2009) 24.

<sup>234</sup> Ibid 40.

Contracting State, which the parties to the dispute consent in writing to submit to the Centre<sup>235</sup>

The ICSID convention therefore limits its jurisdiction to ‘legal disputes’ in order to rule out other types of situations like conflicts of interest that might arise from an investment, without providing any specific definition of the term. The underlying motive for this was to allow enough flexibility for the parties of a dispute to decide what constitutes an investment.<sup>236</sup> Consequentially, the definition tends to be broad enough to include almost all type of economic activity arising from the mobilization of assets.

In South American practice, states have usually adopted the model of developed countries such as the United States or European nations. In the case of the United States, there are three types of models that were used in the region —the BIT models of 1991, 1994, and 2004. The USA 1991-BIT model retained the structure of the clause from the previous models used in that country, especially the wording formula of the 1984 USA BIT model, but introduced changes to the illustrative list of assets included in the definition.<sup>237</sup> One example of this type of treaty can be found in the Argentina-USA BIT of 1991:

‘Investment’ means every kind of investment in the territory of one Party owned or controlled directly or indirectly by nationals or companies of the other Party, such as equity, debt, and service and investment contracts; and includes without limitation: (i) tangible and intangible property, including rights, such as mortgages, liens and pledges; (ii) a company or shares of stock or other interests in a company or interests in the assets thereof; (iii) a claim to money or a claim to performance having economic value and directly related to an investment; (iv) intellectual property which includes, inter alia, rights relating to: literary and artistic works, including sound recordings, inventions in all fields of human endeavor, industrial designs, semiconductor mask works, trade secrets, know-

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<sup>235</sup> art 25, "Convention on the Settlement of Investment Disputes between States and Nationals of Other States" 1965.

<sup>236</sup> para 27 Report of the Executive Directors on the Convention

<sup>237</sup> Vandevelde 119.

how, and confidential business information, and trademarks, service marks, and trade names; and (v) any right conferred by law or contract, and any licenses and permits pursuant to law<sup>238</sup>

In following years, the USA BIT Model that influenced the region was the introduction of the concept 'covered investment' incorporated in the 1994 model, defined for example in the USA-Bolivia BIT as 'investment of a national or company of a Party in the territory of the other Party'<sup>239</sup>. As noted by Vandevelde, the distinction incorporated between 'investment' and 'covered investment' is useful because the treaty refers both to investments to which the treaty applies and other investments that are not covered, such as investments of nationals of the host state<sup>240</sup>.

Finally, the 2004 USA-BIT model maintained the differentiation of covered investment and investment, but increased the scope of coverage by changes in the illustrative list of assets, such as the use of the word enterprise instead of company. It also introduced a new wider wording formula to define investment that would be included later in the BIT negotiated in the region with Uruguay, and in the Free Trade Agreements with Colombia and Peru. For example, the Uruguay-US BIT, uses the following formula:

'investment' means every asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, including such characteristics as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk''<sup>241</sup>

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<sup>238</sup> Article 1 "Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment", 1991).

<sup>239</sup> Article 1 "Treaty between the Government of the United States of America and the Government of the Republic of Bolivia Concerning the Encouragement and Reciprocal Protection of Investment," 1998).

<sup>240</sup> Vandevelde 120.

<sup>241</sup> art 1 "Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment" 2005.

The definitions of investment also incorporated by European negotiation programs used broad definitions, but not as detailed as the aforementioned USA models, while using the phrase 'every type of asset' plus an illustrative list scheme. One example is the Peru-Netherlands BIT:

(a) the term 'investments' shall comprise every kind of asset and more particularly, though not exclusively: i. movable and immovable property as well as any other rights in rem in respect of every kind of asset; ii. rights derived from shares, bonds and other kinds of interests in companies and joint ventures; iii. title to money and other assets and to any performance having an economic value; iv. intellectual and industrial property rights (such as copyrights, patents, industrial designs and models, trade or service marks and trade names), technical processes, goodwill and know-how; v. rights granted under public law, including rights to prospect, explore, extract and win natural resources<sup>242</sup>

The same 'every type of asset' formula has been used in the region by other European states; for instance, Germany has used very similar wording in its agreements with Chile<sup>243</sup>, Paraguay<sup>244</sup>, and Ecuador.<sup>245</sup>

In the following years, after the Treaty of Lisbon entered into force, the competence to negotiate treaties related to Foreign Investment was incorporated into the European Union Common Commercial Policy- established in article 3 of the Treaty of the European Union (TEU) - by the addition of the words 'foreign

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<sup>242</sup> art 1 "Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Peru" 1994.

<sup>243</sup> art 1 "Tratado entre la Republica de Chile y la Republica Federal de Alemania sobre Fomento y reciproca proteccion de Inversiones" 1991.

<sup>244</sup> art 1 "Tratado entre la Republica Federal de Alemania y la Republica del Paraguay sobre Fomento y recíproca protección de Inversiones de Capital" 1993.

<sup>245</sup> *ibid.*



investment' in articles 206<sup>246</sup> and 207<sup>247</sup> of the Treaty of Functioning of the European Union (TFEU). In the use of this competence, the European Union started to negotiate IIAs with a different formula, similar to the one that appears in the consolidated text of CETA, which has not yet been ratified.<sup>248</sup> However, this formula with its concept of investment has not yet entered into force in any country in South America.

With the influence of both the USA and the European BIT Models, the South American countries incorporated the same wording formulas to define investment in the treaties celebrated between them. For example, the Ecuador-Chile BIT states the following definition inspired by the USA 1991 BIT-Model:

El término 'Inversión' designa, de conformidad con las leyes y reglamentaciones de la Parte Contratante en cuyo territorio se realiza la inversión, todo tipo de bienes y derechos relacionados con una inversión efectuada por un inversionista, de una Parte Contratante en el territorio de la otra Parte Contratante, de acuerdo con la legislación de esta última<sup>249</sup>

Other inter-regional IIAs incorporate an express reference to the compliance with legal system of the host state, as one element in the definition of investment.

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<sup>246</sup> art 206: "By establishing a customs union in accordance with Articles 28 to 32, the Union shall contribute, in the common interest, to the harmonious development of world trade, the progressive abolition of restrictions on international trade and on foreign direct investment, and the lowering of customs and other barriers."

<sup>247</sup> 207 TFEU.- "The common commercial policy shall be based on uniform principles, particularly with regard to changes in tariff rates, the conclusion of tariff and trade agreements relating to trade in goods and services, and the commercial aspects of intellectual property, foreign direct investment, the achievement of uniformity in measures of liberalization (...)"

<sup>248</sup> The text is the following: *"Every kind of asset that an investor owns or controls, directly or indirectly, that has the characteristics of an investment, which includes a certain duration and other characteristics such as the commitment of capital or other resources, the expectation of gain or profit, or the assumption of risk. Forms that an investment may take include"* Available in <> accessed 23 September 2015.

<sup>249</sup> art 1 "Tratado Entre El Gobierno de la República de Chile y el Gobierno de la República del Ecuador para la promoción y Protección recíprocas de Inversiones" 1993.

In this sense, the Paraguay– Chile BIT incorporates the condition of conformity with the legal framework of the host state. The wording formulation is the following: ‘as long as it was made in accordance with the laws and regulations of the Contracting Party in whose territory it took place’<sup>250</sup>.

Along the same lines, the Venezuela-Belarus BIT shows how the structure of drafting agreements is even adopted by countries that have been critical of the regime. In this case, the parties to the treaty are Venezuela, a South American country that has terminated most of its IIAs, and Belarus, a country resistant to participating in international economic regimes, uses a translation of the same wording formula included in the European treaties. In this treaty, there is the use of the word ‘*activo*’<sup>251</sup> as a reference to the English word ‘*asset*’ used in the European treaties, while other countries have chosen the use of the Spanish word ‘*bien*’ which has a broader doctrinal development in the legal tradition of the region.

The aforementioned demonstrates that the structure of IIAs in South America has been influenced by European and US models, even when those states are not parties involved in the negotiations.

### ***3.2.1.2 Definition of Nationality***

The second delimitation of the scope of application of an Investment Agreement is determined by the nationality of the investor that accesses the legal protection. In much the same way as happened with the definition of investment, the USA and European models have influenced the South American region.

The US models’ use of the word ‘national’ in preference to ‘citizen’ explains, in part, the use of this term in other agreements. In the US legal system, the term national has a broader meaning, and it was explicitly included for this purpose in a letter of submission presented on April 24, 2000 by the Secretary of the State at the time, Madeleine Albright, who explained: ‘a native of American

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<sup>250</sup> Author’s translation of the original in spanish: “siempre que ésta se haya efectuado de conformidad con las leyes y reglamentos de la Parte Contratante en cuyo territorio se realizó”, contained in art 1 of "Acuerdo entre la Republica de Chile y la Republica del Paraguay para la Promocion y Proteccion Reciproca de las Inversiones" 1995.

<sup>251</sup> "Acuerdo entre la República Bolivariana de Venezuela y el Gobierno de la República de Belarús sobre Promoción y Protección recíproca de Inversiones" 2007.

Samoa is a national of the United States, but not a citizen<sup>252</sup>. Taking this into account, the usual definition of a national of a party is as follows: “‘national’ of a Party means a natural person who is a national of that Party under its Applicable law”.<sup>253</sup>

In the evolution of the BITs program in the United States, dual criteria were included for each of the parties to the agreement regarding the nationality of the investor. For instance, the USA- Uruguay BIT includes each party’s legal standard of nationality<sup>254</sup>. In further treaties that were based on the 2004 USA- BIT model, such as the investment chapter of the Free Trade Agreement with Colombia, there is further use of the term ‘investor of a party’ and the inclusion of state enterprises and a reference to dual nationality, absent in previous treaties. The text of the FTA Colombia-USA includes the following:

investor of a Party means a Party or state enterprise thereof, or a national or an enterprise of a Party, that attempts through concrete action to make, is making, or has made an investment in the territory of another Party; provided, however, that a natural person who is a dual national shall be deemed to be exclusively a national of the State of his or her dominant and effective nationality<sup>255</sup>

The European Agreements usually choose the double standard of nationality for persons, where the law of each state determines the nationality criteria, as in the

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<sup>252</sup> Letter of Submittal, US. Department of State, 24 April 2000,

<sup>253</sup> art 1 Treaty between the Government of the United States of America and the Government of the Republic of Bolivia Concerning the Encouragement and Reciprocal Protection of Investment,.

<sup>254</sup> The text of the article 1 is drafted in the following way: “*national*” means: (a) for the United States, a natural person who is a national of the United States as defined in Title III of the Immigration and Nationality Act; and (b) for Uruguay, a natural person possessing the citizenship of Uruguay, in accordance with its laws., in Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment. Article 1.

<sup>255</sup> art 10.28 "Free Trade Agreement between the United States of America and Colombia, Chapter X Investment" 2006.

Ecuador-Germany BIT<sup>256</sup> and the Chile-Germany BIT.<sup>257</sup> Other European models, such as that of the Dutch, use broader criteria of nationality that includes natural persons; legal persons constituted under the law of that Contracting Party; and legal persons wherever located, controlled, directly or indirectly, by nationals of that Contracting Party<sup>258</sup>.

The intra-regional IIAs in the region were based on the European model, specifically the Dutch one. For example, the Chile-Paraguay BIT uses a concept that includes natural persons and a broad concept of legal entities, either established in the territory of the contracting parties or that conduct 'effective economic activities'.<sup>259</sup> On the other hand, the Paraguay-Venezuela BIT incorporates the concept of legal entities established in the territory where the investment is made, which are '*effectively controlled*'<sup>260</sup> by nationals of the controlling parties.

### **3.2.1.3 Definition of Territory**

The last concept that defines the scope of application of a treaty is the definition of a territory. This concept can be problematic since the duration and situation of each state is quite particular, and for these reasons each state can have an underlying motive for the inclusion of a particular element in the concept. For example, in the Argentina-USA BIT, there is mention of 'the territorial sea established in accordance with international law as reflected in the 1982 United Nations

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<sup>256</sup> art 1.3 "Tratado Entre la República del Ecuador y la República Federal de Alemania sobre Fomento Y Recíproca Protección de Inversiones" 1996.

<sup>257</sup> art 1 Tratado entre la Republica de Chile y la Republica Federal de Alemania sobre Fomento y Reciproca Proteccion de Inversiones.

<sup>258</sup> art 1 (b) Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Peru. See also: the art 1 of the now terminated Venezuela-Netherlands BIT "Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Venezuela" 1991, and the art 1 of the Bolivia-Netherlands BIT "Agreement on Encouragement and Reciprocal Protection of Investments between the Kingdom of the Netherlands and the Republic of Bolivia" 1992.

<sup>259</sup> art 1.1 Acuerdo entre la Republica de Chile y la Republica del Paraguay para la Promocion y Proteccion Reciproca de las Inversiones.

<sup>260</sup> art 1.2 "Convenio sobre la Promoción y Protección Recíproca de Inversiones entre el Gobierno de la República de Venezuela y el Gobierno de la República del Paraguay", 1996).

Convention on the Law of the Sea'.<sup>261</sup> This reference to the Law of the Sea is peculiar considering that the United States is not a party to that Convention<sup>262</sup>. One typical clause introduces a definition of territory for each of the parties. For instance, the Uruguay- USA BIT introduces a different formula:

(a) with respect to the United States, (i) the customs territory of the United States, which includes the 50 states, the District of Columbia, and Puerto Rico; (ii) the foreign trade zones located in the United States and Puerto Rico; and (iii) any areas beyond the territorial seas of the United States within which, in accordance with international law and its domestic law, the United States may exercise rights with respect to the seabed and subsoil and their natural resources.

(b) with respect to Uruguay, the land territory, internal waters, territorial sea, and air space under its sovereignty, and the exclusive economic zone and the continental shelf within which it exercises sovereign rights and jurisdiction, in accordance with international law.<sup>263</sup>

There are exceptional cases where because of political motives there is no express definition of 'territory' as in the case of the USA – Morocco FTA, because as noted by Vandevelde, the United States does not recognize Morocco's claims to the Western Sahara<sup>264</sup>.

### **3.2.2 Specific Treatment Clauses**

The second category groups together specific commitments concerning the treatment of the investor of the other contractual party related to a range of topics, such as taxes, financial services, transparency, war, civil disturbance, etc. The following section will describe the nature of these specific treatment clauses, by illustrating the specific provisions that are used for the responsibility derived from armed conflicts.

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<sup>261</sup> art 1. F) of Treaty between United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investment.

<sup>262</sup> See Vandevelde 170-171.

<sup>263</sup> Treaty between the United States of America and the Oriental Republic of Uruguay Concerning the Encouragement and Reciprocal Protection of Investment.

<sup>264</sup> Vandevelde.

The importance of any war-like provision is crucial in the adjudication process because it can contain the tacit or express recognition by the parties that they will enforce the treaty, even in the case of armed conflict.

There can be two types of ‘war clauses’: compensation for losses clause, and security clauses. First, there is a compensation of damages for losses clause, when the state’s part of an International Investment Agreement (IIA) recognizes an express obligation to compensate for any damages that may be caused by the effects of a situation of violence. Compensation clauses can be sub-divided into two types: those having either an absolute or relative standard of responsibility. Absolute responsibility entails an obligation to compensate losses regarding the treatment to third parties, while relative responsibility entails a non-discrimination obligation to repair the losses of other nationals.

The use of this type of clause introduces an understanding of armed conflict, as any type of violence that can generate losses for an investment. This tacit broad concept of ‘armed conflict’ distances itself from the conventional debate on distinguishing between international and non-international armed conflicts. This distinction is founded on public international law, and is based on the fact that States do not want to legitimize rebels or other armed groups<sup>265</sup> or grant them some type of international personality. On the contrary, the conceptualization of armed conflict used for this type of clause is so broad that it can also include violence arising from ‘internal disturbances’.

The broad concept of armed conflicts introduced in these types of clauses also increases the threshold of responsibility for States, because it can include recent armed conflicts that have been hard to categorize under the *international/non-international* distinction. Considering this, it is difficult for States to accept an absolute standard of compensation, and for this reason, it is more common to include a relative standard of treatment for compensation. For this reason, it is also extremely important to recognize the existence of transversal obligations that can arise either from the interpretation of general or specific ‘Most Favored Nation’ provisions in the treaty. For example, if State A grants investors from State B an

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<sup>265</sup> Thilo Marauhn and Zacharie F Ntoubandi, "Armed Conflict, Non-International", *Max Planck Encyclopedia of Public International Law [MPEPIL]* (2011).

absolute standard of compensation of losses and later State A grants investors from State C a relative standard but with a non-discrimination obligation—either in the same compensation clause, or in a general MFN standard of treatment clause— it can result in spreading the absolute responsibility standard throughout its network of IIAs.

The second types of clause that can be applied to armed conflicts are ‘security clauses’. Their function is different from compensation clauses, because they do not impose an obligation to compensate<sup>266</sup> on the state, but rather seek to exclude acts of the states from the threshold of responsibility. In other words, the function of a security clause is to limit the public authority of arbitrators for action related to security interests.

The ‘war clauses’ are only an example of an investment treaty provision that can cluster together specific standard categories. As mentioned previously, others include a variety of specific commitments or standards that could vary from one model of treaty to another.

### **3.2.3. General Treatment Clauses – Standards of Treatment**

This category groups the standards of treatment that are conceived as general and undetermined concepts which grant the arbitrators a wide range of interpretative powers. There are two types of standards: the absolute and the relative. The first evaluates the actions of the state without comparing them to the treatment granted to others (e.g. Fair and Equitable Treatment and Full Protection and Security). On the other hand, relative standards of treatment refer to norms that allow one to evaluate the lawfulness of the conduct of the state, compare it to the treatment received by either a national or the investor of another country, and embody the principle of non-discrimination (e.g. Most Favored Nation, National Treatment).

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<sup>266</sup>Josef Ostřanský, "The Termination and Suspension of Bilateral Investment Treaties Due to an Armed Conflict" (2015) 6 *Journal of International Dispute Settlement*. 144.

### 3.2.3.1 *Relative Standards of Treatment*

Relative standards have been broadly defined as ‘principles which define the required treatment by reference to the treatment accorded to other investment’<sup>267</sup>. In other words, relative standards are the expression of a principle of Non-discrimination that is embodied in two specific treatments: National Treatment (NT), and Most Favored Nation (MFN). In international trade law, these two standards are located at the core of World Trade Organization (WTO) legal frameworks, and have been incorporated into the general practice of IIAs.

The inclusion of a National Treatment standard in an IIA determines the obligation of the host State to treat foreign investors in the same way as ‘similarly situated national investors’<sup>268</sup>. The use of this standard has been traced back at least to early treaties in the 12th and 13th centuries<sup>269</sup> and has been present in different forms in almost every international economic agreement. The insertion of NT in the normative dimension of the current investment regime was no exception. It can be found in the first BIT between Germany and Pakistan, and it has been used alone or in connection with other standards<sup>270</sup>. However, despite its wide use, NT has one limit within the investment regime: protecting investors against measures that the investor considers to be ‘arbitrary’, when those measures are directed at both nationals and foreigners. This limit means that in investment law, unlike international trade law, relative standards need to engage with absolute ones.

The second standard of treatment is Most Favored Nation status and can be understood as a ‘provision in a treaty under which a state agrees to accord the other contracting party treatment that is no less favorable than that which it accords to

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<sup>267</sup> "Fair and Equitable Treatment Standard in International Investment Law", Oecd Working Papers on International Investment, 2004/03, OECD Publishing <  
<http://Dx.Doi.Org/10.1787/675702255435>>, 2004 2

<sup>268</sup> Andrea K. Bjorklund, “National Treatment” in August Reinisch, *Standards of Investment Protection* (Oxford Univ. Press 2008) 28.

<sup>269</sup> *ibid* 34.

<sup>270</sup> Kenneth J. Vandavelde, *Bilateral Investment Treaties. History, Policy, and Interpretation*, (Oxford Univ. Press 2010) 373.



other or third states'<sup>271</sup>. Its origins can be traced back at least to the 17th century<sup>272</sup>, but since then it has been used frequently in international trade agreements. Like the NT, the MFN clause was incorporated into the current normative dimension of the investment regime since the first BIT<sup>273</sup>, and during the first decades it was viewed more as a 'relic'<sup>274</sup> of old international economic practice. With the rise of investment arbitration at the end of the 19th century, the MFN acquired a special systemic importance for the investment regime. In this sense, MFN is perceived to create a 'level playing field'<sup>275</sup> among different foreign states that in turn also produces a horizontal integration effect across the universe of agreements.

### 3.2.3.2 *Absolute Standards of Treatment*

Absolute standards can be defined as the ones that establish a treatment for foreign investments in terms 'whose exact meaning has to be determined by reference to specific circumstances of application'<sup>276</sup>, and not in relation to the treatment offered by the host state to its own nationals, or the nationals of other states. There are usually three basic absolute standards incorporated in international investment agreements: Customary Minimum, Fair and Equitable Standard (FET), and Full Protection and Security (FPS).

The absolute standards possess a dual nature: (a) as a source of public authority, and (b) as rules of recognition that allow adjudicators to internalize further norms in the process of interpretation. The standards have truly become secondary rules in themselves, in Hart's terms, because they allow arbitrators to

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<sup>271</sup> Andreas R. Ziegler, "Most-Favoured-Nation (NFN) Treatment" in Reinisch 60

<sup>272</sup> *ibid* 61.

<sup>273</sup> Vandevelde.

<sup>274</sup> Reinisch. 59

<sup>275</sup> Wenhua Shan, *The Legal Protection of Foreign Investment a Comparative Study* (Hart 2012) 21.

<sup>276</sup> Fair and Equitable Treatment Standard in International Investment Law", OECD Working Papers on International Investment, 2004/03, OECD Publishing <<http://Dx.Doi.Org/10.1787/675702255435>>. (2004) 2

create special primary rules in the exercise of interpretation. The most prominent example of standards of treatment acting as secondary norms is the Fair and Equitable Standard of Treatment (FET), used by arbitral tribunals in investment disputes in recent years, and the Full Protection and Security (FPS). These standards and their dual nature will be analyzed in more detail below.

### ***3.3 The Transnational Dimension of the Investment Regime***

In addition to the dense network of more than 3,200 treaties that compose the normative dimension of the international investment law regime, there is also a transnational dimension composed of the production of norms generated by transnational and epistemic global communities that have developed criteria of validity embodied in the standards of treatment. For this reason, the legitimacy of international investment disputes cannot be analyzed without acknowledging the transnational dynamics that are beneath the network of treaties and that have developed special obligations for States. These obligations have been developed in more than 700 arbitral awards that have created a type of arbitral precedent in the absence of one multilateral treaty or one single adjudicative body like an international court of arbitration.

The following section will advance this idea by first pointing to specific ‘sectorial constitutional’ moments of this transnational dimension that have gone unnoticed in historical accounts of the discipline, or have been mentioned only as anecdotes, without highlighting their importance. The next subsection within this section will discuss the role of previous awards and absolute standards of treatment at the center of the transnational dimension of the IIL regime.

#### **3.3.1 Two Sectorial Constitutional Moments**

The creation of a national legal system can be traced back to the origins of the state, where it is possible to determine the precise moment of its creation. Domestic legal orders are created with the enactment of a constitution — a legal starting point — that will set the foundational principles, and the rules of recognition, which indicate how norms will be created in the future. By contrast, regimes that have been created within the international arena, outside the state level, usually do not have such a definitive starting point; however, there is usually a series of legal developments

that can be termed constitutional moments, meaning legal pieces that can be identified as the starting point of a regime. In this case, the term '*constitutional*' is used in a broader sense to designate those moments in which the systemic characteristics of a regime are being developed.

This is the case for International Investment Law and its transnational dimension which was not created by one single treaty as in the case of the World Trade Organization, but rather across several *constitutional moments*.

The normative dimension of the regime can be traced to the signature of the first Bilateral Investment Treaty (BIT), celebrated between Germany and Pakistan in 1959 and the BIT between Germany and the Dominican Republic, the first treaty of this kind that entered into force. In addition, another moment inside the normative dimension was the signature of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the ICSID Convention) in 1965.

There has been insufficient attention to the history of the development of the transnational dimension and most references to it have been included in the general narrative of the evolution of the protection of investment in international law. However, if the argument is for the existence of a transnational dimension that interacts and shapes the normative one, then it is important to establish a trajectory for its historical development. In this sense, there are important moments in the construction of the transnational dimension of international investment law. Two are brought up here: *The Abs-Shawcross Draft Convention on Investments Abroad* and the *AAPL vs. Sri Lanka* case.

### ***3.3.1.1 Abs-Shawcross Draft Convention On Investments Abroad***

The first constitutional moment of the transnational dimension of the international investment law regime was the Abs-Shawcross Draft Convention on Investments Abroad. The Draft convention emerged from the evolution of several non-governmental efforts over the last decade but, more precisely, resulted from the combination of two works. The first was a draft developed by the Society to Advance the Protection of Foreign Investments, led by Herman Abs, the Director-

General of Deutsche Bank<sup>277</sup>. The second was the work of a group of lawyers, headed by Lord Shawcross, in 1959<sup>278</sup>. The combined result has become known as the Abs-Shawcross Draft. Its main characteristic is that no government, state or international organization of states conceived the Convention; on the contrary, it was conceived by professionals with legal and economic backgrounds who actually engage in trans-border economic transactions. For this reason, this convention is the expression —a sort of manifesto— of the transnational character of international investment law.

The draft was an answer to a question that Lord Shawcross posed a couple of years earlier in the following way:

[...] Private investors invest to make profit, not for reasons of benevolence. They are prepared to take the often very considerable commercial risks, which are inherent in the establishment of new enterprises. But if they make profits they not unnaturally expect that, subject to normal taxation, they will be entitled to keep them. If they acquire property they expect to be entitled to keep it. It is the feeling of insecurity in these respects, caused by bitter experience in the past, which is perhaps the main deterrent to the flow of private capital to the developing countries. What then does Public International Law do, or can it do, to regulate these relationships and provide the order and security that we are accustomed to find for them under civilized municipal systems?

The answer to this specific question, ‘What then does public international law do to provide order and security?’, synthesizes the essence of the development of a regime based not on the regulation of a transaction, but exclusively on the protection of investment with an emphasis on the need to create<sup>279</sup> a specific ‘order’.

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<sup>277</sup> Andrew Newcombe and Lluís Paradell, *Law and Practice of Investment Treaties Standards and Treatment* (Wolters Kluwer 2009) 21.

<sup>278</sup> Ibrahim F. I. Shihata, *Legal Treatment of Foreign Investment "the World Bank Guidelines"* (Nijhoff 1993).

<sup>279</sup> This explains the conception of this investment regime as one which “protects” investors and it is for this reason it is criticized by the current regime. For a current critique of the “protective” character of international investment law see Yadira Castillo Meneses, *El Sesgo de Debilidad a*

The final version of the Abs-Shawcross Draft addressed the quest for ‘order and security’ for foreign investors with a structure that has become the basis for the transnational dimension and later also shaped the normative dimension, in the sense that it came to determine the structure of IIAs. It did so by establishing a wide range of standards of treatment as the substantive element and arbitration as the only procedural answer. In this sense, the very first article of the Abs-Shawcross Draft contained an extensive version of the Fair and Equitable Treatment standard and constant protection:

Each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties. Such property shall be accorded the most constant protection and security within the territories of the other Parties and the management, use, and enjoyment thereof shall not in any way be impaired by unreasonable or discriminatory measures<sup>280</sup>

The standards elaborated within the above article are not a minor provision, because they would evolve in the following decades along dual paths, as criteria of validity, and as norms that generate a type of public authority. For these reasons, this particular Convention can be considered a defining constitutional moment in the history of the current international investment law Regime. It became a sort of manifesto.

The importance of this instrument has been underestimated by the doctrine, maybe due to the fact that the convention, as such, never entered into force. For this reason, references to the convention are included in the list of failed attempts by non-governmental initiatives to construct agreements for foreign investment. The first of these non-governmental attempts was the ‘International Code of Fair Treatment for Foreign Investments drawn’ and was created by the International Chamber of Commerce (ICC). The text was developed by the Committees on

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*Favor del Inversionista Extranjero un Límite a la Responsabilidad Internacional de las Corporaciones Transnacionales* (Universidad de los Andes 2015).

<sup>280</sup> Georg Schwarzenberger, "The Abs-Shawcross Draft Convention on Investments Abroad: A Critical Commentary" (1960).

Foreign Investments and Foreign Establishments in 1949, and the Code included a reference to 'fair treatment, as hereinafter defined',<sup>281</sup> which limits its scope of application to the text of the code, and is not so wide as the absolute 'fair and equitable treatment' formula that would later be developed. In addition, this Code did not include an investor-state arbitration<sup>282</sup> process for resolving disputes and only stated an obligation to provide access to the domestic courts under the same conditions as nationals and to be entitled to 'appear before the competent administrative authorities'.<sup>283</sup>

During the same time, another attempt, the 'Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Investments Court' was made by the International Law Association (ILA). The importance of this instrument was that it provided a private-public arbitral mechanism in the following terms: 'A national of one of the Parties claiming that between him and a Party there exists a dispute within the meaning of Article 1 may institute proceedings against this Party'<sup>284</sup>. This idea of private-public arbitration was later incorporated into the Abs-Shawcross Draft, in the following way:

A national of one of the Parties claiming that he has been injured by measures in breach of this Convention may institute proceedings against the Party responsible for such measures before the Arbitral Tribunal referred to in paragraph 1 of this Article, provided that the Party against which the claim is made has declared that it accepts

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<sup>281</sup> art 2 of the International Code of Fair Treatment for Foreign Investments drawn up by the I.C.C.'s Committees on Foreign Investments and Foreign Establishments and approved by the I.C.C.'s Quebec Congress (June 1949). Text available in "International Investment Instruments: A Compendium. Regional Integration, Bilateral and Non-Governmental Instruments" (UNITED NATIONS 1996).

<sup>282</sup> The draft contemplates the possibility of state-state arbitration.

<sup>283</sup> art 5 of the Code at International Investment Instruments: a Compendium. Regional Integration, Bilateral and Non-Governmental Instruments.

<sup>284</sup> art 3 of "Draft Statutes of the Arbitral Tribunal for Foreign Investment and the Foreign Investments Court", available in *ibid*.

the jurisdiction of the said Arbitral Tribunal in respect of claims by nationals of one or more Parties, including the Party concerned.<sup>285</sup>

The Abs-Shawcross, is therefore the refined and concrete expression of previous efforts by fragments of society involved in the transnational economic activities of the time. First, it developed a better and broader clause for a minimal absolute standard than that provided in the draft of the International Chamber of Commerce; and, at the same time, it included an improved version of the procedural private-public mechanism from the draft of the International Law Association.

These unique features differentiate the Abs-Shawcross from other non-governmental attempts such as the Harvard Convention on the International Responsibility of States for Injuries to Aliens, drafted in 1961 by Louis Sohn and Richard Baxter at the request of the UN Secretariat. This effort was an attempt to codify the existing rules of State responsibility and for this reason it contained neither a reference to the Fair and Equitable Standard of Treatment (FET) nor a private-public process for the resolution of disputes.

The Abs-Shawcross never achieved the form of a multilateral treaty, as was the original objective of its drafters. However, its importance should not be underestimated. The Draft was a transnational manifesto that contained both the substantive and procedural features that four decades later—for better or for worse— began to work as a regime with two dimensions.

### ***3.3.1.2 The APLL vs Sri Lanka case***

The APLL vs Sri Lanka case has special significance for the construction of the investment regime. There are two reasons. It was the first known case<sup>286</sup> that arose from the network of BITs that had begun to be signed in the second half of the century and was submitted to the ICSID for arbitration. Second, it is the only investment arbitration case involving a conflict with a State undergoing a major

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<sup>285</sup> art 7, Draft Convention on Investments Abroad (Abs-Shawcross draft convention), available in "International Investment Instruments: A Compendium" (UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT 2003).

<sup>286</sup> *Asian Agricultural Products Ltd. (Aapl) V. Republic of Sri Lanka*, International Centre for the Settlement of Investment Disput ICSID Case No. ARB/87/31990 para 18.

armed conflict. Although there had been some important cases involving violence, none came close to the scenario of the civil war of Sri Lanka.

The background of the conflict in Sri Lanka includes decades of internal struggles. The tensions, between the Sinhalese dominated government and the ethnic group of Tamils, were triggered on the 4th August 1983 when a constitutional amendment<sup>287</sup> banned political parties and individuals that advocated separatism from the country<sup>288</sup>. This amendment put an end to the agenda of the Tamil to operate from inside the system to create their own state,<sup>289</sup> giving license to the armed branches, especially the group known as the Tamil Tigers. The result was a conflict that continued for the next three decades between the Sri Lankan government and the radical sector of the Tamils.

The arbitration proceeding arose from an investment made by Asian Agricultural Products Ltd, a Hong Kong corporation, in the form of equity capital of the public company Serendib Seafoods LTD. with the purpose of undertaking 'shrimp culture'<sup>290</sup> in Sri Lanka. The company constructed and operated a shrimp farm in the north part of the country- a place where most combat took place. In January of 1987, this farm was destroyed in an armed operation by the government of Sri Lanka. There is no certainty about what exactly happened that day. The

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<sup>287</sup> See Alan J. Bullion, *India, Sri Lanka and the Tamil Crisis 1976 - 1994 ; an International Perspective* (Pinter 1995) 32-34.

<sup>288</sup> The circumstances that lead to this conflict are without any doubt far more complex than the amendment of 1983. However, this moment has been recognized, even by people very close to Jayewardene's government at the time, as the turning event that precluded any attempt to find an understanding between the Sinhalese government and the Tamil. Bullion writes in his memories: "*The Tamil United Liberation Front, could have negotiated the details of such an arrangement with a Sinhalese government. But the Sinhalese government committed the error of enacting the Sixth Amendment...*" Alfred Jeyaratnam Wilson, *The Break-up of Sri Lanka: The Sinhalese-Tamil Conflict* (Hurst 1988) 228.

<sup>289</sup> The main political party was the Tamil United Liberation Front TULF that re united the so-called Ceylon Tamils, the Indian Tamils and the Tamil speaking Muslims that united in the year of 1976 in the Pannakam convention. One of the objectives of the convention was a mandate to establish a sovereign secular socialist State of Tamil Eelam. See *ibid* 89-95.

<sup>290</sup> *Asian Agricultural Products Ltd. (AAPL) . Republic of Sri Lanka* para 3.



arbitral tribunal concluded that there was no 'convincing' or 'reliable'<sup>291</sup> evidence to sufficiently sustain the investor's allegation that the fire?, which caused the destruction of the property, resulted from acts committed by government troops.

Six months later, the investor requested an ICSID arbitration to seek compensation for the loss of the property of the company during military actions, and it based its claim on the provisions contained in the 1980 UK-Sri Lanka BIT<sup>292</sup> that had been extended to Hong Kong the next year<sup>293</sup>. In this treaty, two clauses can determine the responsibility of the State. First, article 2 contains the Fair and Equitable Treatment, and Full Protection and Security standards<sup>294</sup>. The second provision is article 4 of the UK- Sri Lanka BIT, which includes a specific compensation for losses clause with two provisions. One established a non-discrimination treatment —national and MFN treatment— in terms of restitution or compensation to be paid by the Sri Lankan government in the case of armed conflicts.<sup>295</sup> A second provision in the same article extends the obligation to compensate in the cases of losses during armed conflicts excluding those damages that arose in 'combat action'<sup>296</sup>.

To summarize, the UK-Sri Lanka BIT included three clauses that were possibly applicable to the case: (i) FPS standard; (ii) Non- Discrimination for

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<sup>291</sup> *ibid* para 59.

<sup>292</sup> "Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Democratic Socialist Republic of Sri Lanka for the Promotion and Protection of Investments" 1980).

<sup>293</sup> *Asian Agricultural Products Ltd. (AAPL) v Republic of Sri Lanka* para 1.

<sup>294</sup> Agreement between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the Democratic Socialist Republic of Sri Lanka for the Promotion and Protection of Investments. art 2.

<sup>295</sup> The text reads as follows, article 4: "(1) Nationals or companies of one Contracting Party whose investments in the territory of the other Contracting Party suffer losses owing to war or other armed conflict, revolution, a state of national emergency, revolt, insurrection or riot in the territory of the latter contracting Party shall be accorded by the latter Contracting Party treatment, as regards restitution, indemnification, compensation or other settlement, no less favourable than that which the latter Contracting Party accords to its own nationals or companies of any third State." *Ibid*.

<sup>296</sup> *ibid* art 4.2 (b)

compensation of losses, (iii) and a specific provision to exclude necessary actions during combat. In this sense, the tribunal recognized that rebel Tamil forces occupied the territory where the company was operating<sup>297</sup>. Second, it acknowledged the existence of a combat situation<sup>298</sup>; and, third that the circumstances of the destruction of the farm were not clear.<sup>299</sup> In any case, it was determined that the State had responsibility for lack of due diligence under international law that in connection with the Full Protection and Security Standard.

There appears to be a contradiction in the reasoning of the Tribunal, because it is not clear how the tribunal found that Sri-Lanka had not exercised Due Diligence in the first place, if the same tribunal concluded several times that what actually happened could not be known.<sup>300</sup>

As a result, the Tribunal argument represents a four-step chain of elements that can be summarized in the following way: The government of Sri Lanka was given the burden of proof regarding the necessity of its actions as a pre-condition for the exclusion of the losses of the investor (article 4.2 BIT), and excluded its application. (b) It established that article 4.1 should be applied in the absence of the elements that exclude responsibility in article 4.2 of the BIT. (c) It also determined that the FPS standard should be applied as a *renvoi* from article 4.1. (d) It determined that due diligence was part of the FPS concept. (e) Finally, it analyzed that the government did not use a channel of communication that existed to

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<sup>297</sup> *Asian Agricultural Products Ltd. (AAPL) v Republic of Sri Lanka* para 62.

<sup>298</sup> *ibid* paras 61, 62.

<sup>299</sup> *Ibid* paras 64, 85.

<sup>300</sup> The argument of the tribunal seems to be contained in the following text:

‘The Tribunal is of the opinion that reasonably the Government should have at least tried to use such peaceful available high level channel (referring to communication between security forces and the government explained in previews paragraph) of communication in order to get any suspect elements excluded from the farm's staff: This would have been essential to minimize the risks of killings and destruction when planning to undertake a vast military counterinsurgency operation in that area for regaining lost control. (...)

Accordingly, the Tribunal considers that the Respondent through said inaction and omission violated its due diligence obligation which requires undertaking all possible measures that could be reasonably expected to prevent the eventual occurrence of killings and property destructions’ *ibid*.

communicate with the farm of the investor in order to prevent the destruction of the property. Therefore, for the Tribunal, this omission violated the due diligence obligation that was believed to be part of the Full Protection and Security standard.

This extensive interpretation gives rise to at least two observations. First, the tribunal did not need to undergo such complex reasoning when it had a specific provision for the parties for armed conflicts, contained in article 4.2 of the BIT, as has been criticized both by the dissenting opinion of the third arbitrator, and by commentators<sup>301</sup>. Second, the tribunal determined the violation of due diligence even when the facts were not clear.

The AAPL case illustrates the degree of authority—which in this case could have been unlawful—granted to arbitrators by the use of absolute standards, such as the Full Protection and Security, and it considerably raises the threshold of responsibility. It can be said that the Tribunal does not refer to the FPS as an absolute standard, but the reality shows that even with an express provision on the matter, a State that was involved in a complex armed conflict, at the end was responsible, not even for actions during hostilities, but for inactions.

The AAPL case therefore is a moment of considerable importance in the development of the transnational dimension of the regime; this is because the Tribunal developed a capacity, coming from a treaty, to assess the actions of the state, using a direct remedy initiated by an investor. This case represents a break from the way in which investment disputes were dealt with in the past, not only because it allowed a private company to directly hold a State accountable, but also because of the power granted to arbitrators. In other words, this case was not the typical case involving an expropriation of an investment over the previous decades, or a matter related to commercial disputes. On the contrary, in this case the Tribunal directly evaluated, in great detail, the conduct of the state in the exercise of its competences during an armed conflict, and determined responsibility not for an act, but rather for what the State did not do.

From this point on, states that entered into the normative dimension of the international investment regime by signing international investment agreements

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<sup>301</sup> James Thuo Gathii, "War's Legacy in International Investment Law" (2009) 11 *International Community Law Review* 370-375.

started to lose a part of the control of the regime that was instead yielded to a new type of authority exercised by investment arbitrators. In addition, it was also the beginning of a transnational dimension that cannot be seen only as a mechanism to solve disputes, but also as an exercise of public authority that, in the present case, there are reasons to argue was unlawful.

The importance of the AAPL award had also been undermined, and this case is usually referred to when explaining the FPS standard. However, it was the starting point for a trajectory that would expand and become more complex. It is without a doubt a moment that shaped the discipline and that showed the deficits of the regime that would arise in the following years<sup>302</sup>.

### 3.3.2 Arbitrators Previous Decisions

There are many criteria that can be used to interpret the nature of previous arbitral decisions on investment arbitration. In general international law, the previous decisions of courts are not, on their own, considered as sources, but rather seen as a subsidiary means to determine the content of an existing norm. This view is reinforced by the text of Article 38 (d) of the Statute of the International Court of Justice (ICJ) which expresses that the ICJ will apply: ‘subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of ‘rules of law’’. In this case, the language of the article clearly specifies ‘judicial decisions’ as an auxiliary means to determine the ‘rules of law’. Even more, Article 59 in the article clarifies that ‘the decision of the Court has no binding force except between

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<sup>302</sup> These new types of cases generated a branch of law literature that started in the same decade and has continued up until the present. Among the important treaties that began to discuss the new regime after AAPL see: Rudolf Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (Nijhoff 1995), Christoph Schreuer, *The ICSID Convention: A Commentary on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (Cambridge Univ. Press 2001), M. Sornarajah, *The Settlement of Foreign Investment Disputes* (Kluwer Law International, 2000), M. Sornarajah, *The International Law on Foreign Investment*, (Cambridge Univ. Press 2004), Rudolf Dolzer and Christoph Schreuer, *Principles of International Investment Law* (Oxford Univ. Press 2008), Stephan W. Schill, *The Multilateralization of International Investment Law* (Cambridge Univ. Press 2009).

the parties and in respect of that particular case'. In the light of the reasoning expressed in the SICJ there is no doubt that a previous decision would not constitute 'law' by itself. In addition- strictly speaking in the formal sense- there is no connection between the different investment treaties since there is not a single one, but more than 3000 IIAs and there are as many adjudicative bodies as conflicts.

However, the observation of international investment arbitration shows that parties of the system accorded previous decisions important value. In other words, there not only do investment arbitrators use past decisions to determine breaches of international norms, but also investors and the same respondent States who elaborate their own arguments also make specific reference to previous cases. This way of dealing with precedent can be found when reading almost every investment arbitration process. For example, it is common to see fragments like the following when a State is expressing an argument:

Argentina argues that there are very few awards and authors that postulate the assertion that the standard of fair and equitable treatment is different from the minimum international standard. Based on the findings of the tribunals in *Genin*, *Azinian*, and *S.D. Myers*, Argentina considers that the meaning of this standard is "related to the purpose of providing a basic and general principle", "constitutes a minimum international standard", and "for it to be violated it is necessary that the State receiving the investment incur in acts that demonstrate a premeditated intent to not comply with an obligation, insufficient action falling below international standards or even subjective bad faith." The Respondent emphasizes that in *Myers* the tribunal stated that Article 1105(1) of the NAFTA imposes "fair treatment at a level acceptable to the international community, measured with the highest degree of deference towards domestic authorities." Thus, "[o]nly the reasonableness of the measure claimed to be grievous must be measured, and this, with deference."<sup>303</sup>

This quoted text comes from the award in the case of *Azurix Corp. vs. La República Argentina*, and it can be seen that in a single argument Argentina uses three previous decisions with different legal backgrounds —based on different treaties and different parties. This is just an example, but the same way of

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<sup>303</sup> *Azurix Corp. v La República Argentina*, ICSID CASE No. ARB/01/12 2006 para 333

expressing arguments can be found by simply reading almost any current dispute, where the recurrence to previous decisions is not casual nor merely referential. Actually, it is the opposite: previous decisions are at the center of almost any legal argument on investment arbitration. Furthermore, new categories of concepts that were not expressly inserted in a treaty text have appeared in the last decade, i.e. Investor's 'legitimate or basic expectations', among others.

This observation of the state of international arbitration gives rise to a question that can be summarized in the following way: Why are previous arbitral decisions being used so actively to determine breaches by States and why are arbitral tribunals relying so much on them as a basis for their decisions? There are two trends that can subsume the possible answers given to this question. The first one denies any '*law-a-like* nature' to previous decisions and looks at them just as 'sources of inspiration' or reference, while the second one implies the acknowledgement that previous decisions indeed possess a degree of normativity but provides no consensus as to its nature.

### ***3.3.2.1 Previous decisions as a source of inspiration***

The first trend can lead to framing previous arbitral decisions as merely referential for the process of interpretation. This step was taken by some of the doctrine and arbitral tribunals<sup>304</sup> during the beginning of the last decade, especially during the early NAFTA awards, where it was stressed that previous decisions cannot be considered as a source of obligations. Probably, one of the clearest statements in this sense comes from an award in 2002, where the Tribunal of *UPS v. Canada* stated:

the many bilateral treaties for the protection of investments on which the argument depends vary in their substantive obligations; while they are large in number their coverage is limited; [...] there is no indication that they reflect a general sense of

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<sup>304</sup> See, Mills 475.

obligation. The failure of efforts to establish a multilateral agreement on investment provides further evidence of that lack of a sense of obligation<sup>305</sup>

However, in the following years the number of references to previous cases would qualitatively and quantitatively increase<sup>306</sup>. An explanation for the emerging importance of previous decisions that nevertheless did not grant them any normative value would lead to redefining them not as *de iure* but rather as *de facto* sources, referring to them as 'material sources'<sup>307</sup>. From this perspective, arbitral decisions are in some way 'sources of inspiration',<sup>308</sup> where they constitute valuable guidelines to investment tribunals since other arbitrators have been confronted with similar facts under different treaties that share a similar structure. In addition, this understanding also allows for framing a reference to previous decisions as 'sources of inspiration' in the search for the 'ordinary meaning' of a treaty in the context of the article 31.1 of the Vienna Convention.

The problem with this view is that it falls short of explaining three key developments in the practice of arbitral tribunals in recent years. The first one is that categorizing previous decisions only as 'sources of inspiration' does not in itself explain the more frequent use of new concepts in investment awards, e.g. investors' basic expectations or the principle of proportionality, that were not included in investment treaties in the first place. These new concepts are produced while analyzing claims over breaches of absolute standards that are vague like 'Fair and Equitable treatment'. In this case, it rather seems that investment tribunals, when quoting one another, are not only 'looking' for the 'ordinary meaning' of standards in a treaty but are, in fact, 'creating meaning'.

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<sup>305</sup> *United Parcel Service of America Inc v Government of Canada, Award on Jurisdiction* 2002 para 97, commented also on Mills 474-476.

<sup>306</sup> Jeffery P. Commission, "Precedent in Investment Treaty Arbitration: A Citation Analysis of a Developing Jurisprudence", (2007) 24 *Journal of International Arbitration*, *Kluwer Law International*.

<sup>307</sup> Eric De Brabandere, "Arbitral Decisions as a Source of International Investment Law", in Tarcisio Gazzini and Eric de Brabandere (eds.), *International Investment Law : The Sources of Rights and Obligations* (M. Nijhoff Publishers 2012) 247

<sup>308</sup> *ibid* 264.

The second feature that cannot be fully explained by seeing previous decisions only as ‘sources of inspiration’ is the systemic characteristics of the regime as a whole where a sense of community can be observed. While still chaotic, inside the universe of arbitral decisions we can observe at least trajectories —lines of decisions under the same logic— or ‘dialogues’ between investment arbitrators, and the existence of an awareness on the part of arbitrators of the impact of the concepts that they are developing. One clear statement in this sense can be found in the 2010 award of the *Tribunal of Global vs. Ukraine*. This tribunal expressed the existence of a ‘responsibility to contribute’ in the following curious way:

This is, to the Tribunal’s knowledge, only the third occasion on which a decision has had to be taken on an objection under Rule 41(5). The Tribunal is thus particularly conscious of its responsibility to contribute to shaping both an understanding of the Rule itself and of the procedure which ought to be followed under it,<sup>309</sup>

The understanding of previous decisions as ‘sources of inspiration’ cannot cope with the current practice of investment arbitration, where tribunals are not only looking at and shaping the meaning of abstract provisions of treaties in themselves but are doing so by massively interacting with each other.

The third feature that cannot be explained as ‘sources of inspiration’ or the search for the ‘ordinary meaning’ of absolute standards of treatment is that an arbitral award has the capacity to influence the outcome of future cases even if the new case will be based on a different treaty, with different parties, and different procedural rules, e.g. ICISD or UNCITRAL.

In addition, even in the case that an arbitration tribunal does not resort to the use of a particular previous decision, it is enough that a past award could be used by one of the parties, and as has been shown, both States and investors refer to past awards frequently. In such cases, a group of arbitrators confronted with a specific previous decision must ‘resist’ applying it in their argumentation. If they just omit

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<sup>309</sup> See *Global Trading Resource Corp. And Globex International, Inc. And Ukraine, ICSID Case No ARB/09/11*, International Centre For Settlement Of Investment Disputes December 1, 2010 para 29; and see Brabandere 276.



to analyze a specific argument by one of the parties that was based on a previous decision, the group of arbitrators can be triggering a future annulment remedy in the context of ICSID or cause the non-enforceability of their own award in the case of? UNCITRAL based awards. This is because the omission to analyze the non-application of a concrete previous decision invoked by one of the parties could be used by the losing party in front of a domestic judge, to stop enforceability by arguing that it was not able to ‘present a case’ under art 5.1 (b) of the New York Convention for UNCITRAL cases, or in front of an Annulment ICSID panel to argue that the award failed to state the ‘reasons on which it is based’ according to rule 50.1 (iii) of the Arbitration Rules for ICISD awards.

### ***3.3.2.2 Previous Decisions as Expression of Normativity***

The second trend comprises positions that consider previous awards with sufficient coherence as having normative relevance rather than as a source of inspiration. In this sense, the first clear attempt can be traced back at least to Thomas Wälde’s separate opinion of 2006 in the case of *Thunderbird v. Mexico*, where he expressed the idea of ‘emerging jurisprudence’. Here he stated:

I wish to highlight the need to pay attention and respect to the consolidating jurisprudence coalescing out of pertinent decisions of other authoritative arbitral tribunals, in particularly the more recent decisions applying the NAFTA and international investment treaties which have a similar methodology, procedure and substantive content to NAFTA Chapter XI. While there is no formal rule of precedent in international law, such awards and their reasoning form part of an emerging international investment law jurisprudence. This is again a significant difference from commercial arbitration where there is little authoritative and persuasive precedent, largely because the awards are exclusively formulated for the private parties and because they are generally not publicly available. Investment treaty tribunals should therefore place themselves in the centre of emerging international investment law rather than at or beyond the margin.

While individual arbitral awards by themselves do not as yet constitute a binding precedent, a consistent line of reasoning developing a principle and a particular interpretation of specific treaty obligations should be respected; if an authoritative

jurisprudence evolves, it will acquire the character of customary international law and must be respected. A deviation from well and firmly established jurisprudence requires an extensively reasoned justification. This approach will help to avoid the wide divergences that characterises some investment arbitral awards – not subject to a common and unifying appeals’ authority. Otherwise, there is the risk of discrediting the health of the system of international investment arbitration which has been set up as one of the major new tools in improving good governance in the global economy. But it is also mandated by the reference to applicable rules of international Law (Art. 1131 NAFTA) and thereby Art. 38 of the Statute of the International Court of Justice: An increasingly continuous, uncontested and consistent modern arbitral jurisprudence is part of the authoritative source of international law embodied in “judicial decisions” (Art. 38 (1) (d)) and will develop, with an even greater legally binding effect, into “international custom (Art. 38 (1) (b)), in particular as an arbitral jurisprudence defines in a contemporary treaty and factual context the “general principles of law”<sup>310</sup>

This strong argument for the recognition of the role of investment tribunal awards advances the categorization of awards as ‘consolidating jurisprudence’, and links this jurisprudence to sources of international law, while expressing that the decisions could constitute ‘general principles’ of customary international law in the context of Article 38 (b) of the SICJ. Wälde’s vision of the role of previous decisions could be considered as a body of precedents suspended in the process of materializing into customary international law. The problem with this view is that in these decisions, the States are not actually participating in the formation process, because it is the arbitral tribunals that are shaping the principles, which means customary law without a specific state practice.

To answer this problem —the existence of customary international law without concrete State practice— the defenders of this view provided an

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<sup>310</sup> Thomas W. Wälde, Separate Opinion *International Thunderbird Gaming Corporation v The United Mexican States*, NAFTA arbitration under the UNCITRAL Arbitration Rules January 26, 2006 para 15

explanation by insisting that awards are forming customs inside a ‘new customary international law’<sup>311</sup> paradigm- a position that has been resisted in the doctrine<sup>312</sup>.

Other authors in the same decade explained the nature of previous decisions with different hypotheses like Matthew C. Porterfield’s idea of the ‘common law of investor’s rights’<sup>313</sup>. He draws a parallel between the formation of the ‘minimum standard of treatment’ of foreign investment—including the ‘fair and equitable standard’ that he sees as its new component—and the formation of Common Law by domestic courts in order to argue that such cannot constitute a ‘legitimate norm of international law’<sup>314</sup>. By attacking their legitimacy—in this case used as legal concept—he actually acknowledges the existence of the exercise of a questionable ‘authority’ to create a continuously evolving international ‘common law of investor rights’<sup>315</sup> that does not come from democratic expressions at the state level and where domestic parliaments—Porterfield refers to the US Congress—could not easily be amended.

Over the next years, the number of investment cases, and therefore arbitral tribunals, would dramatically rise from the 300 known cases in 2007 to more than 700 cases by the beginning of 2016<sup>316</sup>. This quantitative increase in cases also situated the use of previous decisions as a more constant feature in argumentation. This inclusion was explained by new arbitral tribunals in different ways, some of them following a similar pattern of argumentation, first pointing out that previous decisions are not binding for future cases but then giving them a systemic value.

For instance, the *Glamis Gold* tribunal sees previous decisions as ‘trajectories’ giving them a systemic importance. It argues this by drawing a

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<sup>311</sup> Matthew C. Porterfield, "An International Common Law of Investors Rights" (2006) 27 *Journal of International Law*, Available at: < <http://scholarship.law.upenn.edu/jil/vol27/iss1/2>> 84-85

<sup>312</sup> See Bernard Kishoiyian, "The Utility of Bilateral Investment Treaties in the Formulation of Customary International Law" (1993) 14 *Northwestern Journal of International Law & Business*.

<sup>313</sup> Porterfield.

<sup>314</sup> *ibid.* 81.

<sup>315</sup> *ibid.*

<sup>316</sup> See the data of United Nations Conference on Trade and Development. IIA Note issue 2, 2015.

distinction between the ‘primary mandate’<sup>317</sup> of an arbitral tribunal which is to solve a dispute, and its subsidiary role in terms of an ‘awareness of the context in which it operates’. Inside this ‘awareness of the context’ previous decisions do not have ‘precedential effect’ for the tribunal but an arbitral tribunal needs to communicate its reasons in case of ‘departing from major trends present in previous decisions’<sup>318</sup>. In this case, the sense of belonging to a system that generates the need of the tribunal to see other cases is evident.

There are cases where, with no formal connection, the use of the same wording in an award by an arbitrator explains his reliance on previous decisions. Such cases are: *Burlington Resources Inc. v. Republic of Ecuador*, *Saipem v. Bangladesh* and *AES Corporation v. the Argentina*, where the same paragraph that argues for a ‘duty’ to adopt solutions established in consistent cases and to contribute to the development of investment law as a part of the ‘rule of law’ can be found. The fact that the same text is being reproduced in different and apparently unconnected awards is explained because all the awards share one arbitrator, Gabrielle Kaufmann-Kohler. This is the text inserted in the three awards:

The Tribunal considers that it is not bound by previous decisions. At the same time, it is of the opinion that it must pay due consideration to earlier decisions of international tribunals. The majority believes that, subject to compelling contrary grounds, it has a duty to adopt solutions established in a series of consistent cases. It also believes that, subject to the specifics of a given treaty and of the circumstances of the actual case, it has a duty to seek to contribute to the harmonious development of investment law, and thereby to meet the legitimate expectations of the community of States and investors towards the certainty of the rule of law.’<sup>319</sup>

Other tribunals do not make any particular claim about their role or reference their duties, but simply heavily rely on previous decisions in their arguments. Probably the strongest categorization comes from the tribunal of

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<sup>317</sup> *Glamis Gold, Ltd. v United States of America*, UNCITRAL rules, award 7 june 2009 para 7.

<sup>318</sup> *ibid.*

<sup>319</sup> *Burlington Resources Inc. v Republic of Ecuador*, ICSID Case No. ARB/08/52010 para 100.

*Occidental vs. Ecuador* where, while analyzing the use of a principle of proportionality in investment arbitration, the tribunal made a reference to a growing body of ‘arbitral law’<sup>320</sup>, to refer to the previous decisions that were discussed. The *Occidental* tribunal does not provide any definition of the nature of this ‘body of arbitral law’, but they refer to past decisions as ‘law’, indicating that in the current practice previous decisions matter more than just ‘material sources’.

We can conclude that despite the absence of a clear doctrine of binding precedent in the field, through the extensive citation of earlier awards, arbitrators have acquired a “quasi-legislative”<sup>321</sup> power that operates either as a ‘material source’ or as a sort of Razian ‘exclusionary reason’<sup>322</sup> that narrows the field of reasons that an arbitrator can rely upon in reaching a new decision inside an epistemic community. Since awards are based on international law norms they constitute an ‘institutionalized power’ —an exercise of public authority— that is not so strong as to be labeled as ‘law’, but neither so weak as to be labeled as a ‘source of inspiration’.

### **3.3.3 The Systemic Nature of Absolute Standards of Treatment**

The standpoint of legal pluralism can be useful for a better analysis of the dynamics involved in international investment law, including the use of previous decisions, but in order to differentiate a transnational dynamic context, at least two elements must be present. The first is the existence of autonomous fragments of society that can be conceived as transnational communities whose demands for rules cannot be satisfied only at the national level.<sup>323</sup> The international investment law regime is shaped as an autonomous fragment of global society rooted in the economic structures of cross-border transactions that are acknowledged in instruments like

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<sup>320</sup> *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador (ICSID Case No ARB/06/11)* para 404.

<sup>321</sup> Catharine Titi, "The Arbitrator as a Lawmaker: Jurisgenerative Processes in Investment Arbitration" (2013) 14 *The Journal of World Investment & Trade* 851-852.

<sup>322</sup> Zachary Douglas, "Can a Doctrine of Precedent Be Justified in Investment Treaty Arbitration?" (2010) 25 *ICSID Review—Foreign Investment Law Journal* paras 6-7.

<sup>323</sup> Fischer-Lescano and Teubner 1010.

the ICSID Convention,<sup>324</sup> and it is visible in the emergence of an international “arbitration investment community” composed of lawyers, arbitrators and scholars specialising in investment arbitration.<sup>325</sup> The second element is the existence of particular sources that are outside the national law-making process.<sup>326</sup> These sources give life to specialised primary norms, and procedural norms on law making and law recognition.<sup>327</sup>

The transnational sources of investment protection are rooted in investment contracts and the emerging interpretation of standards of treatment through the use of previous decisions. Among these the ‘fair and equitable’ and ‘full protection and security’ standards are the most dominant.

### ***3.3.3.1 Fair and Equitable Standard of Treatment***

Christoph Schreuer explains this standard by analogy with the tale of ‘sleeping beauty’<sup>328</sup> because the wording ‘Fair and Equitable’ was included over decades in several international instruments but was only used by different actors and arbitrators in claims, from 2002 when the *Mafezzini vs. Spain* Tribunal used the FET for the first time<sup>329</sup>. This analogy synthesizes the history of the Standards that can be grouped into three periods or generations: the sleeping stage, awaking stage, and a third one that can be labeled as the limiting scope stage.

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<sup>324</sup> See the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, art 25(2)(b).

<sup>325</sup> M Hirsch, ‘The Sociology of International Investment Law’ in Douglas; Pauwelyn; Viñuales (eds), *The Foundations of International Investment Law Bringing Theory into Practice* (Oxford Univ. Press, 2014) 146.

<sup>326</sup> Fischer-Lescano and Teubner. 1010. See also Teubner.

<sup>327</sup> Fischer-Lescano and Teubner 1015.

<sup>328</sup> Christoph Schreuer, “Fair and Equitable Treatment in Investment Treaty Law, Introduction”, *Investment Treaty Law Current Issues II* (The British Institute of International and Comparative Law 2007) 92.

<sup>329</sup> Rudolf Dolzer, “Fair and Equitable Treatment: Today’s Contours” (2014) 12 Issue 1 Symposium on the Law and Politics of Foreign Investment *Santa Clara Journal of International Law*.

The first period is the sleeping stage in which the FET wording can be considered void of any meaning. The main reason for this is that many international instruments that included the FET had not yet entered into force. The words ‘fair’ and ‘equitable’ were used in early treaties; specifically there is mention in the Treaty of Versailles in 1919 to the Members of the League of Nations to ‘make provision to secure and maintain (...) equitable treatment for the commerce of all Members of the League.’<sup>330</sup> However, it is generally accepted that the starting point of the standard was the Havana Charter in 1948, and a few months later in the Bogota economical agreement, inside the Ninth International Conference of American States<sup>331</sup>. Both instruments did not have the support of the international community, yet remained important as the first instruments where the wording ‘fair’ and ‘equitable’ was used.<sup>332</sup> In the following decades, it was present in several instruments, most of them attempts at multilateral investment treaties, like the OECD Convention of 1967,<sup>333</sup> and the UN Draft Code of Conduct on Transnational Corporations of 1983.<sup>334</sup>

Still later, the evolution of the FET entered the awaking stage, which refers to the time where the wording was re-discovered in NAFTA litigation in the nineties. It was at this moment that the FET developed its nature as a rule of recognition, contributing to the expansion of investment regulation in the transnational dimension and, therefore, moving away from its traditional dimension

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<sup>330</sup> Treaty of Peace with Germany, 28 June 1919, Article 23. Quoted by Steve Charnovitz, "What Is International Economic Law?" (2011) 14 *Journal of International Economic Law* 9

<sup>331</sup> art 22 of the “Convenio Económico de Bogotá los Estados Americanos representados en la Novena Conferencia Internacional Americana 2, Bogotá, 02 May 1948.

<sup>332</sup> See, José Gustavo Prieto Munoz, *El Trato Justo y Equitativo en El Derecho Internacional de Inversiones* (Universidad Andina Simón Bolívar y Corporación Editora Nacional 2013).

<sup>333</sup> See art 1.(a) “Each Party shall at all times ensure fair and equitable treatment to the property of the nationals of the other Parties”. In "Draft Convention on the Protection of Foreign Property", in Organization for Economic Cooperation and Development - OECD (ed.), 1967.

<sup>334</sup> See art. 48: “Transnational corporations should receive fair and equitable and non-discriminatory treatment under in accordance with the laws, regulations and administrative practice of the countries in which they operate (...) in "Draft United Nations Code of Conduct on Transnational Corporation, Doc. E/C.10/1983, S.7", in UNITED NATIONS (ed) 1983).

of operation within international law. At this stage, arbitrators started to develop concepts applicable to investment that were not expressly drafted in treaties while trying to find an appropriate interpretation formula for these abstract words. In this context, the FET standard started to puzzle scholars and adjudicators who filled its content with a range of concepts between basic rights such as ‘denial of justice’ to more creative solutions like the ‘legitimate expectations’ of investors.

In addition, two factors added complexity to the task of finding content in the FET wording. First, there is no single method for drafting the FET standard in the universe of IIAs, because every treaty uses different drafting formulas<sup>335</sup>. The many FET clauses in treaties can be organized into three groups: (i) when the wording 'Fair and Equitable' appears alone in a clause. This case raises the question as to whether the FET wording implies a new standard of treatment or if it is an extension of the Customary Minimum Standard (CMS). (ii) The FET wording appears with a reference to the CMS. In this case, the FET standard is believed to be limited by the CMS; (iii) the FET standard appears next to other standards (e.g. National treatment, full protection and security). In this context, the logical question is whether the FET should be understood in context, or in relation to the other standard. The second factor to be considered is if the FET wording does or does not appear in the preamble of the Treaty. The preamble is important under the Vienna convention rules of interpretation, because it can help determine the context of a norm. Therefore, many tribunals used the wording of the preamble to boost creativity in applying the FET to a particular case.

The combination of these two factors results in a very broad range of possibilities for the construction of the FET, and therefore, for its interpretation. The response to this complexity can follow two paths, using either restrictive or expansive criteria for interpretation of the scope of the standard. The restrictive path

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<sup>335</sup> For a complete account of how the Standard is drafted see Ioana Tudor, *The Fair and Equitable Treatment Standard in the International Law of Foreign Investment* (Oxford Univ. Press 2008). Also Fair and Equitable Treatment Standard in International Investment Law”, OECD Working Papers on International Investment, 2004/03, OECD Publishing <<http://Dx.Doi.Org/10.1787/675702255435>>; Patrick Dumberry, *The Fair and Equitable Treatment Standard a Guide to Nafta Case Law on Article 1105* (Kluwer Law Internat. 2013).



assumes that the FET must be understood restrictively, meaning no further than the CMS. In contrast, the broad or expansive view sees the FET as an independent standard. However, in any case, it retains the underlying task of giving a context to the Customary Minimum Standard applied to an investment, if such a thing exists in the first place. This unresolved task has led to creativity on the part of some adjudicators who have put forward the idea of an evolved CMS ‘on steroids’ as in the *Pope vs. Talbot* case.

In this context, the FET, as a norm of international public law, empowered arbitrators - along with other provisions- with the sectorial constitutional capacity to internalize concepts that had never before been dealt with in public international law. The use of this constitutional power granted in the FET, was evident when arbitrators of investment disputes started encircling the described labyrinth of interpretative possibilities by quoting one another in order to internalize concepts - reasonable or not - to shape the current investment regime. The dual nature of the FET had been formed.

The logical reaction was a response from states, even those who supported the regime, as they faced the increasing powers granted to arbitrators. This reaction brought about the third and current stage of the FET where there is an effort to limit the content of the standard by reducing the sectorial constitutional power of arbitrators. The mechanism has been the inclusion of clauses that provide a list of what is understood to be either FET or CMS. The starting point of this stage was within NAFTA, the same Legal Framework that unleashed the FET in the first place, when the NAFTA Commission enacted its interpretative note, in order to limit the scope of the FET in the Customary Minimum Standard. However, this attempt was limited by the fact that the CMI is also a broad concept. Faced with this criticism the Talbot's Tribunal stated that the CMI had evolved giving rise to new possibilities for interpretation. Since then the latest treaties contain details as to what is understood as FET, to limit the discretion of the adjudicators, and therefore limit its constitutional powers. One example of this new generation of clauses is the one included in the investment chapter in the Peru – United States agreement:

For greater certainty, paragraph 1 prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to covered investments. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by that standard, and do not create additional substantive rights. The obligation in paragraph 1 to provide: (a) “fair and equitable treatment” includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world<sup>336</sup>

The intention of the states is clearly to limit the creation of what is referred to as additional substantive rights. In any case, some room for discretion is left open, because in the same treaty there is a text inserted in the annexes: ‘the customary international law minimum standard of treatment of aliens refers to all customary international law principles that protect the economic rights and interests of aliens.’<sup>337</sup> This addition may help to further internalize concepts —and not only Denial of Justice and Due Process— as long as they can be justified as a principle to protect alien rights and interests. Therefore, there is some remaining sectorial constitutional potential in this type of clause.

The last two generations of FET clauses coexist considering that the duration of an IIA ranges from 10 to 20 years, but their contribution to the development of II Law is considerable, specifically because it has allowed for the internalization of a series of concepts that despite already being considered universal had not previously enjoyed any application in the context of investment, i.e. Due Process, and Denial of Justice. In addition, new concepts were developed that had not been dealt with before while opening the door to a second layer of norms. These new concepts can be understood as secondary standards of investment protection, e.g. ‘legitimate expectations’ and ‘transparency standards’, and, they are composed of concepts that were not incorporated in any treaty provision, but were instead created by tribunals, most of the time in the exercise of interpretation of

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<sup>336</sup> art 10.5 (2) of the “Peru - United States of America Trade Promotion Agreement” 2006.

<sup>337</sup> Annex 10-A Customary International Law, *ibid*.

other standards, e.g. 'fair and equitable', 'no expropriation'. These norms lie at the core of the transnational dimension of international investment law.

One prominent example of a secondary standard is that of the 'legitimate' or 'basic' 'expectations' of investors. Under this concept, a state has the unique obligation to protect not only the property of the investor but also the expectations generated by its own conduct. This idea dramatically increases the scope of responsibility undertaken by states. However, this wording formula 'legitimate expectations' does not appear in any investment treaty. The concept was extracted while arbitral tribunals were interpreting the FET standard. In other words, the 'legitimate expectations' standard does not come from the express consent of the state, but from what arbitrators believe that state meant by the words 'fair' and 'equitable'.

It is believed that the Tribunal of *Tecmed vs. Mexico* used this concept of 'basic expectations' for the first time<sup>338</sup> in the following way:

The Arbitral Tribunal considers that this provision of the Agreement, in light of the good faith principle established by international law, requires the Contracting Parties to provide international investments treatment which does not affect the basic expectations that were taken into account by the foreign investor to make the investment. The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations. [...]<sup>339</sup>

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<sup>338</sup> Michele Potestà, "Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept", *Society of International Economic Law (SIEL), 3rd Biennial Global Conference*. Available at SSRN: <<http://ssrn.com/abstract=2102771>> or <<http://dx.doi.org/10.2139/ssrn.21027712012>> 4.

<sup>339</sup> *Tecnicas Medioambientales Tecmed S.A. v The United Mexican States Case No ARB (AF)/00/2*, International Centre for Settlement of Investment Disputes, ICSID. May 29, 2003 para 154. See also para 88.

The Tribunal does not provide any further reasoning for the inclusion of the concept of ‘basic expectations’ rather than this link with the principle of good faith. Since then, a domino effect caused by a series of arbitral tribunals has developed this idea<sup>340</sup>, with most tribunals merely quoting the *Tecmed* case. The use of this standard has generated a great debate about its boundaries. However, what seems important for a pluralistic debate is not whether the concept is reasonable, but rather the logic involved in reaching such a conclusion. The *Tecmed* Tribunal extracts this concept from the wording ‘fair and equitable’ that was in the text of a treaty. As stated before, under the logic of the Art. 38 of the Statute of the ICJ, a valid rule can come from principal sources: conventions, custom, and general principles of law. The *Tecmed* Tribunal chose to establish the obligation of respecting the ‘basic expectations’ from the first source – the BIT signed between Mexico and Spain. However, this treaty does not contain any reference to such an obligation. For that reason, the Tribunal arrives at its conclusion by using the methods of interpretation of Article 31 of the Vienna Convention. Concretely, it was established that the ‘ordinary meaning’ of the words ‘fair’ and equitable’ are drafted in the BIT. The reasoning is as follows:

The Arbitral Tribunal understands that the scope of the undertaking of fair and equitable treatment under Article 4(1) of the Agreement described above is that resulting from an autonomous interpretation, taking into account the text of Article 4(1) of the Agreement according to its ordinary meaning (Article 31(1) of the Vienna Convention), or from international law and the good faith principle, on the basis of which the scope of the obligation assumed under the Agreement and the actions related to compliance therewith are to be assessed.<sup>341</sup>

From this point on, the development of the concept used this award as a precedent for the existence of an obligation to protect the expectations of the investor. The debate centered on three different ramifications of the concept; one

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<sup>340</sup> Trevor J. Zeyl, "Charting the Wrong Course: The Doctrine of Legitimate Expectations in Investment Treaty Law (March 3, 2011)", 2011) 27-28.

<sup>341</sup> *Técnicas Medioambientales Tecmed S.A. v The United Mexican States Case No ARB (AF)/00/2* para 155.

related to the nature of the expectation generated by express promises on the part of a State, a second based on the nature of 'unilateral declarations' by that State, and the last referring to changes in the 'regulatory framework'<sup>342</sup>. However, all of the discussions revolved around the series of awards generated after *Tecmed*.

Notwithstanding, it does not sound coherent that such a sophisticated meaning can come from the 'ordinary meaning' of the words 'fair' and 'equitable'. From this perspective, almost anything could be inferred from those words plus the principle of good faith. After all, if States wanted to elevate the protection of the investment, it is logical that they would introduce express provisions in treaties rather than wait for a group of arbitrators to interpret such a high level of commitment. Moreover, the concept has been linked to other sources such as custom and principles. However, it becomes even more difficult to establish a series of repetitive acts with the element of *opinio juris* in such a way as to believe that states recognize the standard. On the other hand, 'legitimate expectations' have been linked to the source of general principles of law that can be found in local administrative law systems. Even though this seems like a more coherent line of argumentation, it leads to two observations. The first is that the notion of 'legitimate expectations' used in *Tecmed* does not base any argumentation on this point of view. Other tribunals developed the standard in a more coherent way while many others just quote one another. In other words, the standard was not internalized as a principle; this idea came later as a way of understanding it. The second observation is that there is no single uniform expression of legitimate expectation in local administrative systems.<sup>343</sup> In fact, many domestic systems do not even recognize this concept.

The inconsistency of the argument of tribunals for the inclusion of secondary standards leads to the following questions: 1) If states do not expressly establish high standards for protection such as 'legitimate' or 'basic expectations' as well as others, then why did tribunals start to include this extensive argumentative reasoning?; 2) Why is such sophisticated argumentation needed to extract the 'ordinary meaning' of a provision that had already been used for many

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<sup>342</sup> Potestà 2.

<sup>343</sup> See *ibid* 7-12; and Zeyl 12-19.

years? The FET standard was used in binding treaties for years, but this interpretation only emerged over the last 15 years.

The answer to the above questions is rather simple: because it has proven to be effective. It is not just a mere coincidence that the FET standard was developed at the end of a decade that saw investment flow quadrupling. In other words, a specialized sector of a global society eagerly wanted this further development of the legal framework that regulated their activities. These standards of treatment transport the international law to the 21st century leaving many theoretical gaps behind. This is because previously the international law simply did not fulfill the needs of transnational communities.

There is one thing for sure; the general international law that dealt with investment was binary in essence. It had been reduced for a long time to a dilemma: to expropriate or not to expropriate? When after centuries the answer to that question was defined through military aggression and nationalization in some countries, e.g. the Soviet Union and Mexico, the discipline evolved one step towards the next dilemma: to pay compensation or not to pay compensation?<sup>344</sup> On the last years, investment transactions grow quantitatively and qualitatively, and so conflicts arise from such transactions became more complex.

After failing to negotiate trade and investment regimes in the Havana Charter in 1948, the international investment community observed how its twin branch, international trade law, was evolving into a series of negotiation rounds within a single complex multilateral agreement. Since the signature of the first BIT between Germany and Pakistan, the regulation of investment expanded into bilateralism. In this context, the standards of treatment, especially the FET, went beyond being a standard. They became Hart's secondary rule itself: The FET -along with other standards- became the source itself. The standards became the 'rules of recognition' for a tribunal centric Regime.

### ***3.3.3.2 Full Protection and Security Standard***

The 'Full Protection and Security' standard is incorporated in the same clause as the FET standard. There is no certainty about the origin and first use of the FPS

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<sup>344</sup> This step was taken by the hull formula after the nationalization in 1933.

concept, unlike the FET standard which can be traced back to the Havana Charter in 1948. David Collins traced the origins of FPS to at least an 1833 Friendship, Commerce and Navigation Treaty between the United States and Chile<sup>345</sup>. However, the text of the old treaty was more specific and less ambiguous than the one seen today because it clearly introduced the idea of the protection of aliens in the context of non-discrimination from nationals and providing access to justice.<sup>346</sup>

The FPS allows tribunals either to internalize concepts in the Investment Regime or to re-contextualize general international law concepts, whose application in the investment context was not clear. As a result, the FET and FPS have given rise to contradictory interpretations of arbitral tribunals, where there is no consensus as to whether the two standards are actually independent from one another.<sup>347</sup>

Inside its systemic function, the FPS has been used to internalize at least two different rules of responsibility. First, the responsibility arising from the physical security of the investment, which includes violence, generated by private parties.<sup>348</sup> Second, responsibility arising from legal protection, understood as providing means to investors to exercise their rights, and the use of the power of

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<sup>345</sup> David Collins, "Applying the Full Protection and Security Standard of International Investment Law to Digital Assets" (2011) *J. World Investment & Trade* 225. 228.

<sup>346</sup> art 10: "*Both the contracting parties promise and engage formally to give their special protection to the persons and property of the citizens of each other, of all occupations, who may be in the territories subject to the jurisdiction of one or the other, transient or dwelling there in, leaving open and free to them the tribunals of justice for their judicial recourse on the same terms which are usual and customary, with the natives or citizens of the country in which they may be: for which they may employ in defense of their rights such advocates, solicitors, notaries, agents, and factors, as they may judge proper, in all their trials at law; and such citizens or agents shall have free opportunity to be present at the decisions and sentences of the tribunals, in all cases which may concern them, and likewise at the taking of all examinations and evidence which may be exhibited in the said trials.*" "Treaty of Peace, Amity, Commerce and Navigation between Chile and the United States, Signed at Santiago, 16 May 1832" (Oxford Historical Treaties, available in <<http://opil.ouplaw.com/view/10.1093/law:ohf/law-ohf-82-CTS-413.regGroup.1/law-ohf-82-CTS-413?rskey=HpIwCR&result=1&prd=OHT>> accessed 24 August 2015, 1832.

<sup>347</sup> Christoph Schreuer, "Full Protection and Security" (2010) 1 *Journal of International Dispute Settlement.*, "Full Protection and Security" 2

<sup>348</sup> *ibid.*

the states to protect the investor in matters beyond physical protection. There are cases like the BIT Argentina–Ukraine<sup>349</sup>, where there is a clear limitation to the legal protection, ‘*plena protección legal*’, of the investment.

This extensive interpretation of both the legal and physical protection of the investment has generated calls to further establish the responsibility of states in order to protect against circumstances that were not contemplated during the celebration of a treaty that includes the FPS clause. For instance, there are interpretations that have made a connection between the FPS and the responsibility of states during cyber-attacks.<sup>350</sup>

In addition, the FPS empowers arbitrators with a type of public authority, capable of controlling the power of the states under its own authority. The previous statement implies an understanding of authority that can only be developed within the following premise: the current global setting is characterized by an absence of a concept of absolute sovereignty, which means that the exercise of public authority is not exclusive to the State. Therefore, in some cases there may be a confluence of overlapping public authorities within the same physical space.

It is believed that the authority of arbitrators arises from the clauses contained in the majority of IIAs, which specify an arbitration proceeding as a method for solving disputes. However, it is the absolute standards of treatment, i.e. FET, and FPS, used as undetermined concepts, which allow arbitrators to internalize concepts such as ‘previous decisions’ and to assess all kinds of state acts in two ways. First, it allows arbitrators to categorize acts of the state in the exercise of their competences as lawful/unlawful, and second it imposes a cost —economic compensation— in case an act is deemed to be unlawful. An argument can be made that investment arbitrators do not have the power to derogate domestic law or

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<sup>349</sup> The text in Spanish language is the following: “*Cada Parte Contratante, una vez que haya admitido inversiones de inversores de la otra Parte Contratante en su territorio, garantizará plena protección legal a tales inversiones*”. Art 2.2 “*Acuerdo entre el Gobierno de la República Argentina y el Gobierno de Ucrania para la Promoción y Protección Recíproca de Inversiones*,” (UNCTAD International Investment Agreements Database, available in <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/125>> accessed 29 August 2015, 1995.

<sup>350</sup> Collins.



regulation or to limit the state competencies in a formal way. This means that if the acts of the state are found unlawful, the tribunal does not have the power to change the legal situation of the investor in the host state, but to establish compensation.

However, any compensation implies a reputational and economical cost for the country involved. This reputational cost may be difficult to assess, but it has to be acknowledged especially for developing countries who are attempting to develop a good reputation in order to attract flows of capital or for countries that have undergone armed conflicts who have similar needs. The economic cost can be significant. There are several examples of awards that have established compensations that are considerable, especially for a developing country. In addition, since the enforcement of awards is rooted in the mechanism of the ICSID conventions, the New York conventions, it is implied that non-compliance with an award can only be made with a considerable 'degree of difficulty'.<sup>351</sup>

The public authority of the investors is empowered by the use of open and broad concepts like FPS (or FET), because this allows for the inclusion of other concepts that were not expressly recognized in the text of the treaties. There are three argumentative paths, which while they are similar, result in the adjudicator enjoying a high level of discretion.

First, the words 'full protection and security' without any further clarification in a text can be understood by arbitrators as a reference to an independent standard. If they are understood as such, a considerable degree of leeway exists to limit the scope of responsibility of the state in determining the lawfulness of any conduct. Defenders of this position could use the following reasoning: if the parties of a treaty wanted to refer to international custom, they would use the words 'international custom', therefore the meaning of 'full protection and security' must be a different concept.

Second, is the argumentative path that sees the FPS as a reference to international custom. If the parties had wanted to include a very low threshold of responsibility, like a concept of 'absolute responsibility' for the FPS or 'legitimate expectations' on the part of the investors, these same parties would have chosen to

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<sup>351</sup> Ibid 988.

incorporate such words in the text of the treaty. However, a new question will immediately arise: what is the minimum standard of treatment for investors in the 21st century?

The third argument that can be made is that the interpretation of the FPS has to be understood as a part of the FET standard since both wording formulas are often in the same clause, as in the following: ‘Investment shall at all times be accorded fair and equitable treatment, shall enjoy full protection and security.’<sup>352</sup> In this case, the FPS can be considered an obligatory part of the FET. This case will lead to even more open questions with respect to defining the FPS, in the context of the words “fair” and “equitable”.

As a result, any one of the argumentative paths that an adjudicator can take—to see the FPS as a part of international law, or as an independent standard—gives them a broad range of decisions; it empowers them. While the clause for arbitration inserted in a treaty allows arbitrators to solve disputes, standards of treatment such as the FPS confer broad power with respect to the categorization of *lawful/unlawful* acts, a true source of public authority.

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<sup>352</sup> "Agreement between Bosnia and Herzegovina and Ukraine on the Promotion and Reciprocal Protection of Investments" (UNCTAD International Investment Agreements Database, in <<http://investmentpolicyhub.unctad.org/Download/TreatyFile/498>> accessed 29 August 2015, 2002.

#### ***4. The Construction of a South American Principles Discourse in Times of Global Pluralism***<sup>353</sup>

Once international investment law is viewed in terms of the dynamic between its two dimensions (i.e. normative and transnational), understanding the legitimacy— validity, acceptance and moral justification— of investment adjudication becomes a more complex issue because it implies the co-existence of different norms, values and criteria of validity. There are two possible conceptual paths that can be taken given a pluralistic account. The first path entails a more radical pluralist conception, where the justifiability of the international investment regime is not a priority, given that fragments of society have collided and will continue to collide in the ‘messiness of hybridity’<sup>354</sup>, while in each new encounter, lawyers will be instrumental in defending the interests and values of the communities to which they belong. The second path, a counter-hypothesis, is to pursue the justifiability — a minimal one— of authority in the plural global legal arena beyond the national level where there is neither an ‘agent’ with superior resources that can use coercion to induce compliance, nor an ‘established national community’<sup>355</sup> where a traditional democratic process can legitimize authority.

The present chapter seeks to follow the second pluralist path by developing a legal discourse that considers the justifiability of public authority in terms of its degree of interaction, i.e. cooperation, coordination and toleration<sup>356</sup>, with other types of authority, alongside the development of a set of regional principles that can later spread through the same transnational sources of the international investment regime.

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<sup>353</sup> A part of the research contained in the present chapter was published by the peer reviewed Journal of World Investment & Trade, in the article "The Rise of Common Principles for Investment in Latin America: Proposing a Methodological Shift for Investor-State Dispute Settlement", (2016) 17

<sup>354</sup> Berman. 1237

<sup>355</sup> *Law and Governance in Postnational Europe: Compliance Beyond the Nation-State* (Cambridge Univ. Press, 2005).

<sup>356</sup> Roughan. 258

This section takes on the challenge of providing a legal bridge between the rationality of investment arbitration while at the same time establishing the justifiability of the exercise of public authority at the domestic level in South American societies. One viable course of action is to systematize a set of common principles, which implies going beyond State consent to the legitimation of investment arbitration in the international arena and moving towards something more complex than a mere space for ‘power-based interactions’<sup>357</sup> between sovereign States.

In this specific context, a regional legal discourse can be pursued where the authority of investment adjudicators is justified if it observes the principles accepted by the societies affected by its decisions. A discourse-based approach to principles allows for a return to the main source, the ‘original fountain’<sup>358</sup> of all legitimate authority— the people— and, at the same time, authorizes interaction with global regimes, because once a society has consented to be governed by specifically identified principles, they cannot reasonably object when those principles are applied.<sup>359</sup>

The roadmap of this argument proceeds as follows: the construction of such a legal discourse needs to first be detached from the conceptual assumptions of Carlos Calvo, the Argentinean jurist of the 19th century whose ideas evolved within the framework of Vattel fundamentals into a doctrine that has been accepted across the region during the last two centuries and has even re-emerged in some countries in Latin America in the 21st century.

Detachment from this doctrine leaves space for the justifiability of investment authority within a principles-based discourse. However, this discourse demands a basic framework that can be elaborated as having a structure with three clusters: First, a general group of concepts where compatibility exists between the fundamental public law of States with the general principles of law identified by

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<sup>357</sup> Armin von Bogdandy, "Discourse Theory and International Law: An Interview with Jürgen Habermas, Verfblog, 2013/5/12, <http://www.verfassungsblog.de/en/discourse-theory-and-international-law-an-interview-with-juergen-habermas/>", 2013). Accessed 1 March 2016.

<sup>358</sup> See Alexander Hamilton ‘No. 22’ in Hamilton. 112.

<sup>359</sup> Richard H. Fallon. 797.

arbitrators interpreting customary international law, such as the access to justice and due process. Second, an intermediate cluster that includes certain concepts present in the constitutions of South American States, i.e. Legal Certainty, which have a degree of compatibility with interpretations in investment tribunals, but which have not been recognized as general principles of law, as in the case of legitimate investor expectations. Finally, a third cluster of fundamental principles which have been partially or not at all considered by investment arbitrators, but are fundamental in the justification of authority at the domestic level for Latin American States. This last cluster of fundamental principles represents the core element for a new regional legal discourse on investment, and special attention will be given to defining its two principles: transparency and inclusion.

#### ***4.1 The Calvo Conceptual Trajectory and the Critical Approach to Foreign Investment in the 21st Century in Latin America***

The resistance of some Latin American countries compared to the traditional international investment law regime in the 21st century cannot be considered as a new or isolated event; it is based on a conceptual trajectory that started with Carlos Calvo and his work in the 19th century. However, a closer look at Calvo's work shows that he based his writings entirely on the conceptual assumptions of Emer De Vattel<sup>360</sup>. Thus, using Calvo's fundamentals is analysing the complex issues of foreign investment from the point of view of Vattel's world, where States possess an absolute and exclusive power over their people and territory and where the only normative production on the international arena is the agreements between those States. The following paragraphs will describe this trajectory.

##### **4.1.1 Carlos Calvo on the Adoption of Vattel's 'Arrangement' of International Law**

It is not possible to understand the evolution of the doctrinal treatment of foreign investment in Latin America without studying Carlos Calvo (1822-1906), an Argentinean diplomat who also represented Paraguay, and the doctrine expressed in his book *Derecho internacional teórico y práctico de Europa y América*, first

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<sup>360</sup> See Chapter 1, section 1.2

published in 1868<sup>361</sup>. Carlos Calvo's ideas later evolved into the so-called Calvo doctrine, which influenced the legal discourse, the drafting of treaties, and even Latin American Constitutions, such as the Mexican Constitution of 1911.<sup>362</sup> The impact of Calvo's work has made his name present in today's debates and even occasionally in arbitration.<sup>363</sup>

The doctrine can be summarised into two main ideas: first, the principle of non-intervention, based on the concept of equality and independence of States, and secondly, the absolute equality between foreigners and nationals.<sup>364</sup> The first would lead to the prohibition of diplomatic protection for investors and the second would determine that 'redress for grievances'<sup>365</sup> would only be possible before local authorities.

However, a closer look at these two concepts and at Calvo's work in general indicates that his doctrine is not revolutionary because it was built upon the assumptions of previously mentioned Emer de Vattel. As explained in Chapter One, the Vattel logic provides a clear concept of the validity of agreements between sovereigns as law, the exercise of public authority and its justification. In addition, the logic allowed the creation of a positive law of the States within a political configuration of territorially exclusive public authorities, where- in other words- in each defined territory, power is exercised by a sole sovereign State.

Carlos Calvo based his work on those concepts, including numerous express quotes<sup>366</sup> of Vattel's book. Furthermore, Calvo used the fundamental concepts of

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<sup>361</sup> Carlos Calvo, *Derecho Internacional Teorico y Practico de Europa y America* (Durand ed Pedone-Lauriel 1868).

<sup>362</sup> See Antonio Martínez Báez, 'La Cláusula Calvo en el Constitucionalismo Mexicano' in César Sepúlveda Gutiérrez, Antonio Martínez Báez and Alfonso García Robles, *Carlos Calvo: Tres Ensayos Mexicanos* (Secretaría de Relaciones Exteriores 1974) 42.

<sup>363</sup> See for instance *Aguas Del Tunari, S.A. v Republic of Bolivia*, ICSID Case No ARB/02/3, ICSID2005, para 141, footnote 118.

<sup>364</sup> Donald R. Shea, *The Calvo Clause: A Problem of Inter-American and International Law and Diplomacy* (Univ. of Minnesota Press 1955) 19.

<sup>365</sup> *ibid.*

<sup>366</sup> For example, Calvo opens his key Chapter of Rights of equality by quoting Vattel, see Carlos Calvo, *Derecho Internacional Teórico y Práctico de Europa y America* (D' Amyot 1868) 197.

exclusive authority and equality between States developed by Vattel to incorporate them into his reasoning. Accordingly, the treatment of aliens in one State's territory belongs to the exercise of the latter's authority and ought to have been respected by other equal States. This does not mean that Calvo accepted all of Vattel's premises because Calvo manifested dissatisfaction with the order established by European nations,<sup>367</sup> especially with the premises relating to the treatment of aliens.

As a first conclusion, the work of Calvo was not a theoretical revolution, but rather it formed the basis for a legal discourse based on the principle of non-intervention that grouped together most of the then-new Latin and South American countries. Therefore, his merit was the development of a doctrine grounded on solid conceptual ideas, while simultaneously expressing them clearly enough to be understood not only by international jurists, but also by the majority of actors from the region.

The Calvo doctrine was a theoretical instrument to bring the legal relationship between the State and investors back to the national sphere. One hundred years would be needed for countries to internationalise the legal relation again, when the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention) entered into force in 1966, and in 1969 the Chad-Italy bilateral investment treaty (BIT) included, for the first time, a clear investment arbitration clause. Soon afterwards, the use of arbitration started to spread in the network of international investment agreements.

By the 1990s it appeared that any attempts by South American States to pull back the legal treatment to forgings at the domestic level were left behind. However, soon after, a group of countries started to re-float Calvo's fundamentals. The cases of Bolivia and Ecuador are probably the most striking ones, because both countries introduced Calvo-like provisions in their 21st century constitutions.<sup>368</sup> In the case of Ecuador, it incorporated- in 2008- an express constitutional prohibition of the Ecuadorian State to enter in any agreement that 'yields' its sovereign jurisdiction

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<sup>367</sup> Cesar Sepúlveda, 'Presencia viviente de Carlos Calvo' in Sepúlveda Gutiérrez, Martínez Báez, and García Robles 22.

<sup>368</sup> See Katia Fach Gómez, "Ecuador's Attainment of the Sumak Kawsay and the Role Assigned to International Arbitration", (2011) 447-483.

to international arbitration entities with the exception on Latin America<sup>369</sup>. The Bolivian constitution contains a similar provision for 'foreign enterprises' that carries out activities in the 'chain of production of hydrocarbons in name and representation of the State'.<sup>370</sup>

#### **4.1.2 From Carlos Calvo to the Latin American Critical Approach of the 21st Century**

The use of Calvo's ideas in the present century in Latin America can be explained by looking closely at the recent history of the countries in the region and their problems in the last few decades. The Argentinean jurist Roberto Gargarella identifies at least two specific and important 'dramas' that shaped the structure of the constitutions of countries in the region, but can also explain the re-emergence of the Calvo doctrine in the 21st century: the terrible human rights' abuses committed during different dictatorships in the 1970s, and the severe social crises provoked by programmes of economic change or adjustments imposed by international institutions,<sup>371</sup> such as the International Monetary Fund (IMF). In particular, the social chaos attributed to economic adjustment programmes generated social claims for the reestablishment of strong presidential authorities.<sup>372</sup>

These two elements help to understand various normative developments in Latin America. For instance, they explain why some constitutions in the region- specifically the ones of Bolivia, Ecuador, and Venezuela- engaged in apparently contradictory developments, as made evident by Gargarella, with the enactment of extensive bills of rights while at the same time concentrating power in the hands of

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<sup>369</sup> See art 422 of Ecuador's Constitution (2008). "Constitucion de la Republica del Ecuador 2008", 2008). See also, Katia Fach Gómez, "Latin America and Icsid: David Versus Goliath? " (2011) 501 *Law and Business Review of the Americas*. Katia Fach Gómez 'Latin America and ICSID: David versus Goliath?' (2011) 17 *Law and Business Review of the Americas* 501.

<sup>370</sup> art 366 of Bolivia's Constitution (2007), "Constitucion Politica del Estado Plurinacional de Bolivia" 2007.

<sup>371</sup> For a detailed account of the impact of these historic events on the constitutions in the region see Roberto Gargarella, *Latin American Constitutionalism, 1810 - 2010 the Engine Room of the Constitution N* (Oxford Univ. Press 2013) 148-155.

<sup>372</sup> *ibid* 151.



the executive, a fact which can prevent those rights from being effective.<sup>373</sup> From an international law perspective, these circumstances determine a re-assertion of an absolute concept of sovereignty that resembles that of the 18th century.

This constitutional structure of the States has two effects on the field of international investments. First, the concentration of power in the executive branch might lead to arbitrariness despite the extensive bill of rights expressed in the same constitution, with the risk that such arbitrariness will extend to both nationals and foreign investors. Second, States of the region might want to pull back from the international investment legal framework, limiting investment protection to the domestic level or, in other words, once again impose some of Calvo's fundamentals, such as making redress for grievances possible only before local authorities.

Nevertheless, it seems to be a hard enterprise to use the fundamentals of the Calvo doctrine and to bring the legal regulation of foreign investment back to the nation-State in the current global legal setting for at least three reasons. To begin with, this would involve a large majority of States to simultaneously pull out of the international regime of investment protection. This is not likely to happen because a prisoner's dilemma<sup>374</sup> exists among developing countries, whereby the need to attract capital and technology leads them to compete with each other. Secondly, even in the unlikely scenario that a large majority of States do withdraw from the network of international investment agreements, these treaties contain sunset or survival clauses. These clauses extend the treaty's protection to investors for periods which can last up to 25 years after the denunciation of the treaty.<sup>375</sup> Finally, the world society is too interconnected in this century, which was not the case in the years of Calvo,

In addition, there is an inherent danger of re-establishing Calvo fundamentals where States exercise an exclusive authority in their territory, without

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<sup>373</sup> *ibid* 157.

<sup>374</sup> For a more complete analysis of the dynamics in the region, see Prieto Munoz 97-100.

<sup>375</sup> The periods used in this type of clause vary from 5 to 25 years, see Joachim Gordon Kathryn; Pohl, "Investment Treaties over Time - Treaty Practice and Interpretation in a Changing World", *OECD Working Papers on International Investment* (Organisation for Economic Co-operation and Development 2015) 19.

the possibility of obtaining remedies outside the domestic level. The danger entails that a strong presidential system empowered with such authority would, in the end, put at stake the same extensive bill of rights that had been approved in the new constitutions for its own citizens. In addition, this type of authority can undermine not only matters of economic governance, but also other regional efforts like the Inter-American Human Rights System (IAHRS). This can be seen in cases like Venezuela, where the state has denounced both treaties like the ICSID Convention and also the IAHRS.

#### ***4.2 The Framework for the Construction of Common Investment Principles in Latin America***

For the reasons explained in the previous section, it seems pertinent to put aside Calvo's postulates and their conceptual assumptions. South American States in the current global legal setting cannot hold a strong conception of sovereignty, as it would prevent them from fully integrating with global governance structures. However, any legal discourse that departs from Calvo's postulates for foreign investment must also come hand in hand with an alternative way of legitimization for authority.

One viable solution is to systematize a set of common South American principles by analysing and distinguishing fundamental concepts to legitimize public authority that are common to States of the region and that are expressed in legal text either normatively in their constitutions or developed by regional adjudicators. This represents a quest in two dimensions: a vertical dimension which looks at the relation between South American States and the regional adjudicators created by them and a horizontal dimension that is aimed at identifying common concepts in the different constitutions of South American States.

The result of this analysis leads to an outcome that in turn can lead to three different clusters of principles. First, a general group of concepts where compatibility exists between the fundamental public law of States with the general principles of law identified by arbitrators while interpreting the international customary law, such as the access to justice and due process. Second, an intermediate cluster that includes certain concepts present in the constitutions of Latin American States, i.e. Legal Certainty, which have a degree of compatibility

with the interpretation on investment tribunals, but which have not been recognized as general principles of law, as in the case of investor legitimate expectations. Finally, a third cluster of fundamental principles which have been partially or not considered at all by investment arbitrators, but are fundamental in the justification of authority at the domestic level for Latin American States, such as the principle of transparency and principle of inclusion.

#### **4.2.1 South American General Investment Principles Cluster**

This cluster contains those general principles of law that are also recognized as fundamentals in the constitutions of South American States, and that have been interpreted by arbitrators as forming part of the minimum standard of treatment to investors. There are two identifiable principles: due process of law and access to justice- or the flipside of the same coin- the prohibition of denial of justice.

Usually, access to justice and due process have been interpreted as part of other standards of treatment of investors, especially the FET standard<sup>376</sup> and other specific standards<sup>377</sup>. However, they can be found at the constitutional level of most South American States, where the following may be encompassed.

Constitutions of the regions recognized a right to due process with different elements. Some, like in the case of Argentinian constitution, refer to the right to due process in the defence of the person and of rights as ‘inviolable’<sup>378</sup>. The Paraguayan constitution refers to an ‘equality in access to justice, for which effect it will level the obstacles that would prevent it’<sup>379</sup>. The constitution of Venezuela includes a more detailed version of what is understood for due process. For instance, it includes a right of persons ‘to have access to the evidence and to be afforded the

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<sup>376</sup> See Dolzer 89-93.

<sup>377</sup> For instance, See the specific ‘effective means’ standard in *Chevron Corporation (USA), Texaco Petroleum Company (USA) v The Republic of Ecuador* 2011. *Chevron Corporation and Texaco Petroleum Company v Republic of Ecuador*, UNCITRAL, Partial Award on the Merits (30 March 2010) paras 248, 254.

<sup>378</sup> See for example, art 18 of the Argentinian Constitution. ("Constitucion de la Nacion Argentina" 1994).

<sup>379</sup> See art 47(1) of Paraguay’ s Constitution ("Constitución de la República de Paraguay" 1992); art 76(7c) of Ecuador’s Constitution (2008).

necessary time and means to conduct his or her defence'<sup>380</sup>. In other constitutions like the case of Bolivia there is an express mention to a 'right to be heard by a competent, impartial and independent jurisdictional authority'<sup>381</sup>. Finally, there are constitutions like the Peruvian that include a warranty of due process, referring to the idea that 'no one shall be punished without judicial proceedings'<sup>382</sup>

The observance of due process and access of justice must also be undertaken in the investment arbitration process, but in addition, a regional principle can operate as an authoritative element when the State is the one that has violated it. This means that a decision of an investment tribunal regarding the violation of due process against an investor can have more social acceptance if there is a connection with the responsibility of the state for the breach of a fundamental regional principle in addition to the breach of a specific international obligation contained in a treaty.

The need for the tribunal to determine, with precision, the international legal obligation whose breach gives rise to the State's international responsibility is technically correct.<sup>383</sup> However, additional reference to 'principles' and 'important norms' of the host State and region can enhance, without a doubt, the argumentative strength of an award. For example, the *Occidental v Ecuador* tribunal advanced a far-reaching concept of proportionality, perceiving it also in light of the Ecuadorian Constitution.<sup>384</sup> This draws the link between, on one hand, concepts developed in international law and in international investment dispute settlement, and on the other hand, principles of the state itself.

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<sup>380</sup> See art 49(1) of Venezuela's Constitution ("Constitucion de la Republica Bolivariana de Venezuela", 1999).

<sup>381</sup> art 120(I) of Bolivia's Constitution; see also art 75 of Ecuador's Constitution.

<sup>382</sup> art 139(10) of Peru's Constitution (1993), "Constitución Política del Perú" 1993.

<sup>383</sup> This is one of the elements of an internationally wrongful act determined in Article 2(b) of the Articles on Responsibility of States for Internationally Wrongful Acts.

<sup>384</sup> *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Award (5 October 2012) paras 396-401.

#### 4.2.2 South American Intermediate Principles Cluster

This category first seeks to cluster concepts that have been developed by investment arbitrators in the process of interpretation of absolute standards<sup>385</sup> going beyond the text of treaties, and secondly seeks to find a level of compatibility with regional principles of the South American nations. In recent years, investment arbitrators have developed derivative standards, or standards of second order, not expressly recognised by the text of treaties, but developed through the interpretation of absolute standards. The most prominent example is the ‘legitimate expectations’ of investors.

This concept was first developed by arbitral tribunals<sup>386</sup> in the interpretation of the FET standard and indirect expropriation clauses. According to this concept, a State has an obligation to protect not only the property of the investor but also the expectations generated by its conduct. This approach dramatically increases the scope of responsibility undertaken by States when subscribing to an FET clause. However, the formula ‘legitimate expectations’ does not generally appear in investment treaties. Arbitral tribunals developed it from a sort of ‘arbitral dialogue’ in their interpretation of the FET standard.

One of the most important elements that led to the concept of the investors’ legitimate expectations<sup>387</sup> is probably the idea of stability and consistency of the host State’s legal system.<sup>388</sup> The ‘legitimate expectations’ as such are not recognised in the legal systems of the region. For instance, Potestá, in his quest for justification of the concept of ‘legitimate expectations’, expressly acknowledges that in Latin America such a principle appears to be in its ‘infancy and its scope to

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<sup>385</sup> For a definition of absolute standard see OECD (2004), ‘Fair and Equitable Treatment Standard in International Investment Law’, OECD Working Papers on International Investment, 2004/03, OECD Publishing. <<http://dx.doi.org/10.1787/675702255435>> accessed 1 March 2016.

<sup>386</sup> The first tribunal that used the concept of the investor’s ‘basic expectations’ was *Técnicas Medioambientales Tecmed SA v. The United Mexican States*, ICSID Case No. ARB(AF)/00/2, Award (29 May 2003) para 154.

<sup>387</sup> See in the section 2.3.3.1 Fair and Equitable Standard of Treatment of this work.

<sup>388</sup> For a concrete discussion on expectations based on the host State’s legal order, see Dolzer. 22-24; See also the related analysis in Kenneth J. Vandevelde, "A Unified Theory of Fair and Equitable Treatment", (2010) 43 *International Law And Politics* 81-82.

date is fairly limited'.<sup>389</sup> In this regard, it may be more plausible to speak of the principle's inexistence rather than its infancy.

The protection of expectations that are neither based on specific international norms nor on the fundamental principles of the nations, seems to be a misuse of the arbitrators' authority which could compromise their legitimacy; if States had wished to elevate their responsibility to a higher degree in order to include the mere expectations of investors, they would have used more concrete terms.

In this sense, it is better to further develop a concept like 'legitimate expectations' with a principle of legal certainty (*seguridad jurídica*) embodied in some of the constitutions in the region. Three constitutions of the region make a reference to the idea in different ways. First, the constitution of Bolivia states that power to impart justice emanates from the 'Bolivian people and is based on the principles of [...] *legal certainty*'<sup>390</sup>, but without specifying what its content is. Then, the constitution of Venezuela links the idea of 'reliability of the law' (*garantizando la seguridad jurídica*) with the economic system of the state with in the following way:

The State, jointly with private initiative, shall promote the harmonious development of the national economy, to the end of generating sources of employment, a high rate of domestic added value, raising the standard of living of the population and strengthen the economical sovereignty of the country, guaranteeing the reliability of the law [...]<sup>391</sup>

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<sup>389</sup> Michele Potestà, "Legitimate Expectations in Investment Treaty Law: Understanding the Roots and the Limits of a Controversial Concept", (2013) 28 *ICSID Review*. 97.

<sup>390</sup> The original text in Spanish 'La potestad de impartir justicia emana del pueblo boliviano y se sustenta en los principios de [...] seguridad jurídica', art 178 of Bolivia's Constitution.

<sup>391</sup> Original Spanish text: 'El Estado conjuntamente con la iniciativa privada promoverá el desarrollo armónico de la economía nacional con el fin de generar fuentes de trabajo, alto valor agregado nacional, elevar el nivel de vida de la población y fortalecer la soberanía económica del país, garantizando la seguridad jurídica [...]' see art 299 of Venezuela's Constitution.

The third state to include the idea in its constitution is Ecuador, by referring to legal security and conceptualizing it as a right ‘based on respect for the Constitution and the existence of prior legal regulations that are clear, public and applied by the competent authorities’<sup>392</sup>. Other States do not include *legal certainty* as a whole concept, but as part of the due process, like in the case of the Peruvian constitution that anyone should be subjected to ‘proceedings other than those previously established’<sup>393</sup>.

The contours of a regional legal certainty concept are still not very clear, but in any case, it seems more likely that concepts developed on investment arbitration like the one of ‘legitimate expectations’ will be further constructed inside a regional principle of ‘*seguridad jurídica*’. In addition, a problem lies in the lack of certainty as to the meaning of this expression and the absence of a truly regional character of the principle, since only the abovementioned countries include the term in their constitutions.

#### **4.2.3 South American Fundamental Principles Cluster**

This last category of principles represents the core of the Latin American discourse of common principles for investment because it is a set of concepts that have been partially developed, like in the case of transparency principle, or that have not been considered at all on investment arbitration, like in the case of the principle of inclusion. Even more, if a discourse-based approach is persuasive enough, these principles can be used by the same arbitrators while deciding over a dispute, to increase the moral and social acceptance of their decisions.

In addition, for the purposes of developing a legal discourse, this cluster represents an opportunity to make the particularities of Latin America visible for investment arbitrators. Two key principles are considered in this paper: a procedural principle of transparency and a substantive principle of inclusion or egalitarian principle.

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<sup>392</sup> Original Spanish text: ‘El derecho a la seguridad jurídica se fundamenta en el respeto a la Constitución y en la existencia de normas jurídicas previas, claras, públicas y aplicadas por las autoridades competentes’. art 82 of Ecuador’s Constitution.

<sup>393</sup> Constitución Política del Perú.

### ***4.3 Principle of Transparency***<sup>394</sup>

The ‘transparency’ debate has regained importance in the global legal setting, where a series of adjudication processes must be inserted in different contexts and topics, including international investment law. In addition, different concepts of transparency have been developed, linking the concept with the one of availability of information. Anne Peters refers to the concept as a ‘culture, condition, scheme or structure in which relevant information is available’.<sup>395</sup> Julie Maupin, in her construction of transparency for International Investment Law, adds to the notion of availability the need that the information must be ‘accessible’, ‘adequate’, ‘accurate’ and ‘relevant’<sup>396</sup>. Those concepts are useful, but the construction of a legal principle of transparency on International Investment Law is necessary where the availability of information represents the exercise of two rights: access to information and freedom of expression.

In this regard, there has been a considerable development in the accessibility standards in the different instruments of international arbitration. The following section briefly describes these developments.

#### **4.3.1 Transparency on Investment Arbitration Instruments and Treaties**

First, ICSID arbitration rules have been updated in order to tackle some of the issues of transparency. ICSID arbitration does not possess specific rules for the issues of transparency and confidentiality, but rather allows space to the parties of the dispute to determine it. However, in the silence of the parties, it can be said that

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<sup>394</sup> The findings of this section were presented during the conference ‘Transparency vs Confidentiality in International Economic Law: Looking For An Appropriate Balance’, which took place in Ravenna on 20 November 2015.

<sup>395</sup> Anne Peters, ‘Towards Transparency as a Global Norm’ in Andrea Bianchi and Anne Peters, *Transparency in International Law*, (Cambridge Univ. Press, 2013) 534.

<sup>396</sup> The author extracts this element from the concept developed by Chayes, Handler and Mitchell, in Julie Maupin, *Transparency in International Investment Law: The Good, the bad and the Murky* in *ibid* 149.



confidentiality prevails. For instance, under article 53(3) of ICSID arbitration rules there is an explicit prohibition of the Secretariat to publish the award without the consent of the parties, but to determine an obligation to ‘promptly include’ publications of legal reasoning of the Tribunal. In addition, under article 39(2), public access to hearings is possible, in the absence of objection of the parties, and safeguarding confidential information. Therefore, the parties still control the access to the process.

UNCITRAL rules of arbitration have also undergone an evolution, where the access of information has gained importance. This includes the periodic revision of its rules of arbitration, arriving to the United Nations Convention on Transparency in Treaty-based Investor-State Arbitration (Mauritius Convention on Transparency), that was opened for signature on 17 March 2015. This convention extends the application of the UNCITRAL rules on transparency. The rules of transparency incorporate the standard to ‘promptly communicate’ the commencement of arbitral proceedings to the arbitration repository. This notification includes the information about the name of the disputing parties, the economic sector, and the treaty under which the claim is being made.<sup>397</sup>

In relation with the process itself, the Convention establishes which specific documents ought to be public,<sup>398</sup> and determines that hearings in general terms should also be public<sup>399</sup>. Regarding the exceptions, the Convention provides a list of information considered confidential, including: confidential business information, information that is protected against being made available to the public either by the treaty, the law of the respondent state, under any law or rules determined by the arbitral tribunal, and finally, information which would impede

<sup>397</sup> UNCITRAL Rules on Transparency in Treaty-Based Investor-State Arbitration Resolution (adopted by the General Assembly on 16 December 2013 on the report of the Sixth Committee A/68/462) (2014) (United Nations Commission on International Trade Law) art 2.

<sup>398</sup> *ibid* art 3 ‘The documents specified in the Convention are: the notice of arbitration, the response to the notice of arbitration, the statement of claim, the statement of defense and any further written statements or written submissions by any disputing party; a table listing all exhibits to the aforesaid documents and to expert reports and witness’.

<sup>399</sup> *ibid* art 6.

law enforcement<sup>400</sup>. As a conclusion, the Mauritius Convention provides a coherent framework for distinguishing and balancing transparency and confidentiality and has more determinacy than the ICSID arbitration rules.

In this trend, several treaties -especially regional- are incorporating rules related to transparency. On the South American practice, the Chapter of Investment of the Additional Protocol of the *Alianza del Pacífico*, between Colombia, Chile, Peru and Mexico, represents an important development. The text incorporates a whole set of transparency rules in Article 10.21 that follow the UNCITRAL standards. In particular, it determines the publicity of the most important documents as well as the existence of public hearings. In addition to the UNCITRAL standards, there is a special exception of the insertion of the concept of '*seguridad esencial*' (*essential security*) in article 18.3 of the Protocol<sup>401</sup>, that establishes the exception to disclose information that one of the parties considers contrary to its essential interests in security.

Transparency provisions are increasing; this is good news for states, investors and the global civil society. Even more, the so-called '*mega-regionals*' are including UNCITRAL standards, like the latest Trans Pacific Partnership (TPP), of which Peru and Chile are members.<sup>402</sup> This treaty incorporates an express call to 'promote transparency, good governance and rule of law'<sup>403</sup> in its preamble, and the UNCITRAL standards<sup>404</sup> in a similar way to the ones described for the *Alianza del Pacífico*. The economies of the parties of the treaty represent about 40% of the global economy. This leads to the belief that such rules are going to be established as part of general practice for any future treaty or even are making transparency a principle of customary international law.

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<sup>400</sup> *ibid* art 7.

<sup>401</sup> Protocolo Adicional al Acuerdo Marco de la Alianza del Pacífico (signed 10 feb 2014, entered into force 20 July 2015) (2014).

<sup>402</sup> The Parties of the treaty are: Brunei, Chile, New Zealand, Singapore, Australia, Canada, Japan, Malaysia, Mexico, Peru, United States, and Vietnam.

<sup>403</sup> Trans-Pacific Partnership (drafted 5 Oct 2015, signed 4 February 2016) (2015) (TPP).

<sup>404</sup> *ibid* art 9(23).

Despite all these great normative developments, the issue of transparency remains anchored to the consent of the parties which is a conceptual basis that should be overcome. The great majority of the treaties that are currently in force depend on the parties' consent, and treaties like the TTIP will only enter into force—if ever—after a long and difficult process of ratification on the different states. Even the Mauritius Convention will be entered into force six months after the date of deposit of the third instrument of ratification, acceptance, approval or accession (Article 9). Under the paradigm of state consent, transparency, in the context defined in the present section, remains an option.

However, if arbitrators exercise a type of public authority, as it has been argued in Section I, transparency is not optional: it is of mandatory application in the process of legitimation of an investment tribunal. Transparency becomes one core principle of the South American investment discourse.

Accordingly, this statement is only true if transparency is rooted in the primary and basic rules of the South American nations—their constitutions. In this case, if arbitrators, for the nature of its functions, do not possess a democratic based legitimation capacity, they do have an obligation to fulfill the basic principles that the nations—not the states—of the region have determined to rule the exercise of authority.

#### **4.3.2 The Contours of a South American Principle of Transparency**

The principle of transparency in the region extends to the exercise of two fundamental rights: the access to information and the freedom of expression, both in their individual and collective dimensions. Since the end of the 20th century, a series of rights emerged in the different new constitutions and legal practices of the states of the region. In this context, the Chilean constitution of 1980 contains the following Article 8, which was later introduced in 2005:

The exercise of public functions obligates its holder to comply strictly with the principle of probity in all their actions. The acts and resolutions of organs of the State, as well as their fundamentals and the procedures used, are public. However, only a law of qualified quorum can establish the confidentiality or secrecy of those or of

them, when disclosure would affect the proper fulfillment of the functions of these organs, the rights of persons, the security of the Nation or the national interest.<sup>405</sup>

While the principle of probity can be interpreted in a wider sense, the fact that the next part of the article refers to the publicity of resolutions and its procedures determined that such principles include a standard of transparency as part of probity or integrity.

Other constitutions in the region contain similar provisions. Venezuela's constitution states that 'Public Administration is at the service of the citizen and is based on the principles of (...) transparency.'<sup>406</sup> The Constitution of Bolivia declares the need to create 'transparent management of information and use of resources in all of the places of governance'.<sup>407</sup> In general, this provision creates a direct link between governance, the exercise of public authority on the state level, and transparency understood as policy and access of information. Finally, the Ecuadorian Constitution of 2008 determines in Article 100: 'At all levels of government, entities of participation shall be set up (...) Participation in these entities is aimed at: 4. Building up democracy with permanent mechanisms for transparency, accountability and social control.'<sup>408</sup> In the aforementioned constitutional provisions there is a connection between the exercise of government—public authority—and transparency.

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<sup>405</sup> Constitución Política de la República de Chile (2005) art 8 of the Chilean Constitution (author translation). The original text reads as follows: Artículo 8 de la Constitución Política de la República: "*El ejercicio de las funciones públicas obliga a sus titulares a dar estricto cumplimiento al principio de probidad en todas sus actuaciones. Son públicos los actos y resoluciones de los órganos del Estado, así como sus fundamentos y los procedimientos que utilicen. Sin embargo, solo una ley de quórum calificado podrá establecer la reserva o secreto de aquéllos o de éstos, cuando la publicidad afectare el debido cumplimiento de las funciones de dichos órganos, los derechos de las personas, la seguridad de la Nación o el interés nacional*". "Constitución Política de la República de Chile", 1980.

<sup>406</sup> Constitución de la República Bolivariana de Venezuela (1999) art 141.

<sup>407</sup> Constitución Política del Estado Plurinacional de Bolivia (2007) art 242 (4).

<sup>408</sup> Constitución de la República del Ecuador (2008) art 100.

On the other hand, other states of the region rather develop this understanding of access of information as part of the right of freedom of expression. For example, the Colombian Constitution incorporates the following provision: 'Every individual is guaranteed the freedom to express and diffuse his/her thoughts and opinions, to transmit and receive information that is true and impartial [...]'<sup>409</sup>. The relation to the right of freedom of expression can be explained by the fact that the absence or the lack of information affects the capacity of an individual to engage in the public debate about certain issues. Therefore, the absence of information can limit or even amount a violation of the right of freedom of expression. Yet the question that emerges is whether the access of information is a right in itself or if it is a manifestation of other rights<sup>410</sup>.

The Inter-American Court of Human Rights has further developed the right of access to information in the region. In the landmark 2006 case of *Claude Reyes v. Chile*, the Court held:

The right to 'seek' and 'receive' 'information', Article 13 of the Convention protects the right of all individuals to request access to State-held information, with the exceptions permitted by the restrictions established in the Convention. [...] Consequently, this article protects the right of the individual to receive such information and the positive obligation of the State to provide it, [...] The delivery of information to an individual can, in turn, permit it to circulate in society, so that the latter can become acquainted with it, have access to it, and assess it. In this way, the right to freedom of thought and expression includes the protection of the right of access to State-held information, which also clearly includes the two dimensions, individual and social [...]<sup>411</sup>

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<sup>409</sup> Constitución Política de Colombia (1991) art 20. "Constitución Política de Colombia.", 1991.

<sup>410</sup> For a discussion about the relation of these two concepts see José Manuel Díaz De Valdés, "El Derecho de Acceso a la Información Pública: Su Reconocimiento por El Tribunal Constitucional", in Arturo Fermandois (ed.), *Sentencias Destacadas 2007 (Libertad y Desarrollo 2008)*.

<sup>411</sup> *Caso Claude Reyes Y Otros v Chile*, Corte Interamericana de Derechos Humanos Sentencia 19 September 2006 (Fondo, Reparaciones y Costas) 2006. *Caso Claude Reyes y Otros v Chile* (19 September 2006) Corte Interamericana de Derechos Humanos Sentencia de Fondo, Reparaciones y Costas Series C No 151 para 77.

The vision of the Court grants a regional dimension to transparency since the state legal systems are bound to the Inter-American System, thus a development by the Court can influence the reasoning and construction of rights by local courts. One of the contributions of this sentence is that the Court develops a construction of access to information, not only as an individual right but also in the context of its social dimension.

In addition, other organs of the Inter-American system have consolidated the transparency principle as the exercise of an access to information and freedom of expression. In the year 2010, the Special Rapporteur for Freedom of Expression of the Inter-American Commission introduced the access of information as one of ‘good judicial practices’. This document is important because it is the result of several meetings of judges, academics and representatives of state institutions and civil society in different countries of the region. Later, in 2013, the same Commission reaffirmed that the observance of rights and freedoms in a democratic system requires an institutional order in which laws prevail over the will of power<sup>412</sup>. In particular, the Inter-American Commission extended the access of information to the process of appointment of judges by stating:

As an element of transparency to be observed in the selection process, the Commission welcomes the fact that the procedures are open to scrutiny social sectors, which significantly reduces the degree of discretion of the authorities responsible for the selection and appointment and the consequent possibility of interference by other powers [...] <sup>413</sup>

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<sup>412</sup> Inter-American Commission on Human Rights, ‘Garantías para la Independencia de las y los Operadores de Justicia. Hacia El Fortalecimiento del Acceso a la Justicia y el Estado de Derecho en las Américas’ (OEA/Ser.L/V/II. Doc. 44, 5 December 2013) para 1.

<sup>413</sup> Ibid. Personal translation, Para 80. The full Spanish text is the following: ‘Por otro lado, además de la publicidad de los requisitos y procedimientos, como un elemento de la transparencia a observarse en los procesos de selección, la Comisión considera positivo que los procedimientos sean abiertos al escrutinio de los sectores sociales, lo cual reduce significativamente el grado de discrecionalidad de las autoridades encargadas de la selección y nombramiento y la consecuente posibilidad de injerencia de otros poderes, facilitando la identificación del mérito y capacidades

To conclude, the access of information is a fundamental principle in the exercise of authority on judicial process in the region. In addition, the relevant information includes not only the documents of a particular process, but also covers the system as a whole as the appointment of the persons that will operate the judicial branch.

#### **4.3.3 The Application of the Regional Principle of Transparency on Investment Arbitration**

The question that immediately arises is whether this emerging regional principle of transparency, rooted in the constitutions of the South American States, and in the Inter-American System of Human Rights, can be applied in investment arbitration. This issue is not a minor one, since all of these norms create a direct responsibility of the states and do not address arbitration tribunals. On the other hand, investment arbitrators are concerned about respecting the norm —treaty, law or contract— which grants them jurisdiction over a dispute, and/or the procedural rules or the mechanism of arbitration chosen by the parties, for example ICSID.

In the current context of plurality, arbitrators can be influenced by a regional discourse of principles. The reasoning behind commercial arbitration is that the competence of an arbitrator rests upon the will of the parties; therefore, under that logic, if a state consents to arbitration, by either a treaty or a contract, it is automatically granting competence to investment arbitrators. Moreover, if a violation of rights occurs, it will be the state who is responsible under international law. However, if investment arbitration is seen not only as a mechanism of resolution of disputes, but also as an exercise of authority as the present work argues, then the situation is different.

Constitutions and Human Right treaties have established a reference of the right to access information for the states because they represent an authority and therefore it is necessary to contain that power. Transparency —along with other principles— thus constitutes a prerequisite for the exercise of authority of the states.

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profesionales de las y los candidatos. La Comisión considera que lo anterior resulta fundamental cuando se trata de la designación de las y los operadores de justicia de las más altas jerarquías y el procedimiento y selección se encuentra a cargo del poder ejecutivo o legislativo.’

If the authority of arbitrators overlaps the former, then it has to comply with the fundamental principles that the citizens have established for the justification of such authority.

There are four scenarios of applicability of this regional discursive approach: (i) in the absence of transparency rules determined by the parties; (ii) in the intention of one or both parties extending confidentiality beyond its intended purpose; (iii) on the enforceability of awards that manifestly have broken the fundamental principle of transparency; (iv) in the extension of the scope of transparency to other issues not covered by UNCITRAL rules or investment treaties.

The first scenario represents one of coordination, or complementariness where in the absence of specific rules of transparency in a conflict, arbitrators can implement the higher standards provided in the UNCITRAL rules and it can reaffirm its decision by the recognition of common principles applied in the region.

The second scenario is conflictive and therefore is less likely to happen. In this case, one or both parties can oppose to the access of information by a third party for any ground. The Tribunal can publish information that is not included in the exceptions established in the treaties, such as national security. However, if both parties oppose to the access of information, it is very unlikely that an arbitration tribunal will confront the parties and order its publication. In this not very likely scenario where a tribunal releases information that considers of public interest the discursive approach on a principle of transparency might prove useful to explain such decision.

The latter situation can lead to the third situation, where the principles of investment are used not by an arbitrator, but for a local judge or other tribunal to deny the recognition of an award that has been rendered in a process that manifestly broke any standard of transparency. This case can only seem plausible in awards for which enforcement is framed in the New York convention. In this case, a ground for refusal of recognition and enforcement can fall inside Article V (2)b established for awards 'contrary to the public policy of that country'. The function of the public policy is to allow states to prevent the 'intrusion of awards' into their legal system, which they consider irreconcilable. However, this ground of refusal is rarely



granted. For instance, in a study of Switzerland, the provision was invoked 142 times on commercial arbitration, from 1989 to 2009, and dismissed each time.<sup>414</sup>

The fourth scenario represents the use of the principle to expand the relevant information determined as necessary under UNCITRAL rules. In particular, two grounds: the information related to the appointment of arbitrators and the one related to the cost of the process. As previously mentioned, there is a fundamental link between the access of information and the appointment of judges on the national systems. It is important for a society to recognize the merits of the person administering justice and to observe the process of how that person was appointed. In addition, transparency in this regard makes future decisions more authoritative and justified on sociological and moral terms. On the contrary, the opacity of the qualities of a judge, regardless of his or her virtues, create the opposite effect. Therefore, the transparency on the appointment of arbitrators extends to the process of its selection, and includes the public scrutiny about possible conflicts of interest.

The second area includes extending the principle of transparency to the information of all the arbitration costs that have been paid with taxpayer's money. The Inter-American Commission of Human Rights, through the Special Rapporteur for Freedom of Expression, elaborated a document where study the good practices in judicial access the information recognizing a 'right to know the salaries or income from public resources'.<sup>415</sup>

If this criterion is applied to investment arbitration, then the access of information should include the amounts of money that states pay not only to the tribunal, but also to all persons and institutions involved in the arbitration. Here there is again a line that should be made between commercial and investment arbitration. On the one hand, in a commercial arbitration, private entities assume

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<sup>414</sup> Reinmar Wolff and Christian Borris, *New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards of 10 June 1958 ; Commentary Convention on the Recognition and Enforcement Of*, (Beck, 2012) 488-492.

<sup>415</sup> Inter-American Commission on Human Rights, 'Informe Anual de la Comisión Interamericana de Derechos Humanos 2010 Informe de la Relatoría Especial para la Libertad de Expresión, Relatora Especial para la Libertad de Expresión Dra Catalina Botero' (OEA/Ser.L/V/II. Doc.5, 7 March 2011).

the costs of the process. On the other hand, a state obtained its financial resources from either: its citizens using its taxation power, contracting debt which is also paid by its citizens (sometimes in several generations), or by using the resources of the country such as controlling the exploitation of natural resources. At the end of the day, the population of a country will pay the bill, at least in part, of the investment process. With that premise, the access to the information must include the right to know the amount of public resources used in an arbitration process.

#### ***4.4 Principle of Inclusion***

A significant issue, sometimes overlooked outside Latin America, is the social and economic exclusion of significant parts of the population that live under precarious economic and social conditions. This, in turn, generates inequality with the rest of the members of the population who have better opportunities and some economic stability. The construction of a Latin American principle-based approach to international investment law could not be considered as such if it did not provide legal answers to make this regional problem visible in the adjudication of investment discourse. On the contrary, investment arbitrators will dramatically increase their acceptance in the region if they implement a legal concept, in the scope of their field, which acknowledges these complex issues.

In this quest, it is useful to look at other Latin American approaches on public law that have studied the relation of authority and the issues of inequality in the region for years. One particular approach of Latin American constitutionalism, known as *Ius Constitutionale Commune*<sup>416</sup>, provides a clear starting point: a legal concept of ‘inclusion’. The concept of inclusion represents a legal response to the social-economic inequality in Latin America and it aims to integrate all people into the social welfare system, i.e. health, education, economic and political systems. It

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<sup>416</sup> See Armin Von Bogdandy, Héctor Fix-Fierro, and Mariela Morales Antoniazzi, *Ius Constitutionale Commune En América Latina Rasgos, Potencialidades Y Desafíos* (Universidad Nacional Autónoma de México; Max-Planck-Institut Für Ausländisches Öffentliches Recht Und Völkerrecht; Instituto Iberoamericano De Derecho Constitucional, 2014); Armin Bogdandy, Mariela Morales Antoniazzi, and Eduardo Ferrer Mac-Gregor, *Ius Constitutionale Commune en Derechos Humanos en América Latina* (Porrúa 2013).

is composed of two elements: redistribution and recognition.<sup>417</sup> Redistribution implies a legal obligation of the State to improve the social conditions of its population while recognition is aimed to achieve visibility of parts of Latin American societies that have been marginalized for years, such as indigenous peoples.

Developing an understanding of inclusion in international investment law is challenging since there is no legal obligation- nor should there be- for an investment tribunal to redistribute wealth in a country, even if investment adjudicators exercise a type of relative public authority. However, the construction of a principle of inclusion can help investment adjudicators assess or contextualise the conduct of the State and prevent them from reaching a calculation of damages that can financially make it difficult for States to integrate part of their population living under precarious conditions.<sup>418</sup>

In this respect, two arguments can be advanced. First, it would be useful to establish the existence of a normative and fundamental obligation of the states for inclusion in the region. This changes the perspective of inclusion from just a rhetoric argument to being seen as a fundamental legal obligation the state has to fulfil. Second, it is necessary to determine a way that the authority of arbitrators recognises and acknowledges such legal fundamental obligations while solving investment disputes.

#### **4.4.1 Normative Base for a Principle of Inclusion**

One argumentative step consists of determining that inclusion is indeed an element on the fundamental public law of the South American States. In this regard,

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<sup>417</sup> Laura Clérico and Martin Aldao, 'De la Inclusión como igualdad en Clave de Redistribución y Reconocimiento Rasgos, Potencialidades y Desafíos para el Derecho Constitucional Interamericano' in Bogdandy, Fix-Fierro, and Morales Antoniazzi 221

<sup>418</sup> In recent years there have been a series of cases that establish considerable amounts for compensation, see: *CME Czech Republic BV v Czech Republic*, UNCITRAL, Award (14 March 2003); *Siemens AG v Argentina*, ICSID No ARB/02/8, Award (6 February 2007); *Ceskoslovenska Obchodni Banka, AS v Slovak Republic*, ICSID Case No ARB/97/4, Award (29 December 2004); *Occidental Petroleum Corporation, Occidental Exploration and Production Company v Ecuador*, ICSID Case No ARB/06/11, Award (5 October 2012).

concepts of social, economic, and political inclusion can be found in all legal systems in the region on three different forms that can be grouped into three categories.

The first category consists of countries that have introduced strong obligations for inclusion in their constitutions. The Brazilian Constitution provides an express mandate for the Federal Republic to ‘eradicate poverty and substandard living conditions and to reduce social and regional inequalities’<sup>419</sup>. In the same line, the Constitution of Bolivia in the economic organisation of the State determines that ‘all forms of economic organization have the obligation to generate dignified work and to contribute to the reduction of inequalities and to the eradication of poverty’.<sup>420</sup> Finally, the Constitution of Ecuador establishes that one of the State’s prime duties is ‘planning national development, eliminating poverty, and promoting sustainable development and the equitable redistribution of resources and wealth to enable access to *Buen vivir*’<sup>421, 422</sup>.

The second category groups constitutions of South American States that include a reference to the quality of life or economic development as objectives of the State. For instance, the Constitution of Paraguay mandates:

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<sup>419</sup> Original Spanish text: ‘Todas las formas de organización económica tienen la obligación de generar trabajo digno y contribuir a la reducción de las desigualdades y a la erradicación de la pobreza’. Article 3(III) of Brazil’s Constitution (1988). “Constitution of the Federative Republic of Brazil.”, 1988).

<sup>420</sup> Original Spanish text: ‘Todas las formas de organización económica tienen la obligación de generar trabajo digno y contribuir a la reducción de las desigualdades y a la erradicación de la pobreza’. Article 312(II) of Bolivia’s Constitution.

<sup>421</sup> The Ecuadorian Constitution of 2008 includes the concept of *Buen vivir* that literally can be translate as ‘good leaving’. However it pretend to include on the Constitution of a concept refer by indigenous communities as *sumak kawsay*, taken from Quichuan language— the most important language of indigenous communities in Ecuador. The contours of this concept on the constitutional sphere are still not defined, for that reason it is only referred on the present work as *Buen vivir* without further translation.

<sup>422</sup> Original Spanish text: ‘Son deberes primordiales del Estado: [...] 5. Planificar el desarrollo nacional, erradicar la pobreza, promover el desarrollo sustentable y la redistribución equitativa de los recursos y la riqueza, para acceder al buen vivir. Article 3(5); see also article 3(1) of Ecuador’s Constitution.

The quality of life shall be promoted by the State through plans and policies that recognize conditioning factors, such as extreme poverty and the impediments of disability or of age. The State shall also promote research on the factors of population and their links with socioeconomic development, with the preservation of the environment and with the quality of life of the inhabitants.<sup>423</sup>

Along the same lines, the Constitution of Argentina establishes, as a mandate to the legislative branch, an obligation to ‘provide whatever is conducive to human development, to economic progress with social justice, to the productivity of the National economy, to the generation of employment’ and also to ‘provide for the harmonious growth of the Nation and for populating its territory; to promote differentiated policies that lead to balancing the irregular development of Provinces and regions’<sup>424</sup>, while the Constitution of Guyana cites an economic goal of development.<sup>425</sup>

There is also a third group of constitutions that includes references to a concept of inclusion. For instance, the Constitution of Peru, which establishes a fundamental ‘duty of the State to promote general welfare based on justice and the comprehensive and balanced development of the Nation’.<sup>426</sup> In the same line, the

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<sup>423</sup> Original spanish text: ‘La calidad de vida será promovida por el Estado mediante planes y políticas que reconozcan factores condicionantes, tales como la extrema pobreza y los impedimentos de la discapacidad o de la edad. El Estado también fomentará la investigación sobre los factores de población y sus vínculos con el desarrollo económico social, con la preservación del ambiente y con la calidad de vida de los habitantes’, art 6 of Paraguay’s Constitution.

<sup>424</sup> Original spanish text: ‘Proveer lo conducente al desarrollo humano, al progreso económico con justicia social, a la productividad de la economía nacional, a la generación de empleo, a la formación profesional de los trabajadores, a la defensa del valor de la moneda, a la investigación y desarrollo científico y tecnológico, su difusión y aprovechamiento. Proveer al crecimiento armónico de la Nación y al poblamiento de su territorio; promover políticas diferenciadas que tiendan a equilibrar el desigual desarrollo relativo de provincias y regiones’, art 75(19) of Argentina’s Constitution (1994)

<sup>425</sup> art 14 of Guyana’s Constitution (1980), "Constitution of the Co-Operative Republic of Guyana Co-Operative Republic of Guyana" (1980).

<sup>426</sup> Original spanish text: ‘Son deberes primordiales del Estado: [...] proteger a la población de las amenazas contra su seguridad; y promover el bienestar general que se fundamenta en la justicia y en el desarrollo integral y equilibrado de la Nación’. art 44 of Peru’s Constitution (1993).

Colombian Constitution provides that the state ‘shall intervene in order to rationalize the economy with the purpose of [...] the improvement of the quality of life of the inhabitants’, and it later adds: the state shall intervene for the sake of the full employment of the human resources and to ascertain that all individuals, especially those with a low income, may have effective access to all basic goods and services.’<sup>427</sup> Finally, the Chilean Constitution cites a duty of a ‘harmonious integration’ of all the sectors of the Nation.

In addition, the concept of inclusion goes beyond social and economic and includes political issues. This implies the recognition and integration of all groups that have not already been fully integrated in the society and in decision-making processes, such as indigenous people.<sup>428</sup> This has also been acknowledged in the constitutional texts, and in the jurisprudence of the Inter-American Court of Human Rights;<sup>429</sup> the latter has further developed the concept of previous consultation as a way of empowering indigenous communities to choose the destiny of their own lands.<sup>430</sup>

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<sup>427</sup> Original spanish text: ‘El Estado, de manera especial, intervendrá para dar pleno empleo a los recursos humanos y asegurar que todas las personas, en particular las de menores ingresos, tengan acceso efectivo a los bienes y servicios básicos. También para promover la productividad y la competitividad y el desarrollo armónico de las regiones. art 334 of Colombia’s Constitution (1991).’

<sup>428</sup> ‘Access to Justice and Social Inclusion: The Road Towards Strengthening Democracy in Bolivia, Oea/Ser.L/V/Ii. Doc. 34’ (Organization of American States Inter-American Commission on Human Rights, 2007) para. 229.

<sup>429</sup> See for example *Kichwa Indigenous People of Sarayaku v Ecuador* (27 Jun 2012) Inter-American Court of Human Rights Series C No 245 paras 159-161.

<sup>430</sup> See *Awas Tingni Community v Nicaragua* (31 Aug 2001) Inter-American Court of Human Rights Series C No 79; *Yakye Axa Indigenous Community v Paraguay*. Merits, (17 Jun 2005) Inter-American Court of Human Rights Series C No 125; *Sawhoyamaya Indigenous Community v Paraguay*. Merits (29 March 2006) Inter-American Court of Human Rights Series C No 146. *Saramaka People v Suriname* (28 Nov 2007) Inter-American Court of Human Rights Series C No 172; *Xákmok Kásek Indigenous Community v Paraguay* (24 Aug 2010) Inter-American Court of Human Rights Series C No 214.

#### 4.4.2 Contours of a South American Principle of Inclusion

As it has been shown, the idea of inclusion is common in all the basic norms of the Countries of the region, either as an express and fundamental mandate for the State to eradicate poverty, improve life conditions and reduce inequalities, or by the introduction as an objective for the economic development of its citizens.

The use of these types of constitutional clauses can be explained by the fact that South America has been considered as one of the most unequal regions in the world, and also explains that what binds the region together are not only cultural similarities, e.g. language, or origin, but also 'common dramas'. However, the use of the described clauses on constitutions makes inclusion a legal problem because it creates a fundamental legal obligation that affects the way public authority should be exercised in the region.

The constitutional clauses determine and limit the way that the State should use its institutionalised power. These constitutional norms do not provide specific rules for arbitrators. However, in the context of global plurality, where several legal regimes interact and even collide, tolerance and visibility of other types of authorities is necessary in order to legitimise arbitral decisions. This raises a number of questions of how the authority of arbitrators should interact with these provisions and how those fundamental norms could (or should) impact while assessing the responsibility of a State of the region in an investment conflict.

In this context, three further considerations about the operational character of the principle of inclusion on investment arbitration are appropriate. First, the construction of a principle of inclusion should not be confused or used as an excuse by a host State for expropriation without compensation or for any other arbitrary act. This case will amount to an abuse of the concept, because it will turn the principle into a euphemism, for example for confiscation, and it will empty it of its content.

Second, the principle of inclusion in investment law can be applied when evaluating the responsibility of a State in the merits phase of a particular case. Then, arbitrators could assess the proportionality<sup>431</sup> of State conduct when deciding about

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<sup>431</sup> See Alec Stone Sweet, "Investor-State Arbitration: Proportionality's New Frontier " (2010) 4 *Law and Ethics of Human Rights*.

the breach of treaty provisions, and in particular the absolute standards of treatment. Under the inclusion paradigm, the breach of absolute standards of treatment contained in IIAs should be considered in the light of States' essential obligation to integrate the less favoured fragments of society into social welfare systems.

Third, regardless of the reason for the breach of an obligation, and in extraordinary cases, an arbitration tribunal should not impose a compensation that will damage the State's capacity to fulfil its functions because in that case it would be sanctioning the vulnerable fragments of society. This means an extraordinary obligation for arbitrators to exercise self-restraint in determining the amount of compensation, only in cases when there is room for their discretion. In this sense, the assessment of the economic 'capacity to pay' has been already discussed by international adjudicators outside the region in the Eritrea - Ethiopia Claims Commission damages award, in the following way:

The Commission also considered whether an award of compensation should be limited as necessary to ensure that the financial burden imposed on Eritrea would not be so excessive, given Eritrea's economic condition and its capacity to pay, as seriously to damage Eritrea's ability to meet its people's basic needs. As discussed previously, claims of compensation in claims of this magnitude may raise significant questions at the intersection of the law of State responsibility and fundamental human rights [...]<sup>432</sup>

One example where the principle could have been used in South America was the *Occidental v Ecuador* case where the tribunal held that standards of treatment in the Ecuador-USA BIT had been breached. At the same time, it acknowledged a wrongful act on behalf of the investor: the latter had failed to obtain prior ministerial authorisation to transfer rights under a Participation Contract, reduced the amount of compensation by 25%, and justified the amount as the 'exercise of its wide discretion'. This was the reasoning of the tribunal:

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<sup>432</sup> *Eritrea Ethiopia Damages Claims Commission*, The Hague, Final Award Ethiopia's Damages Claims (17 August 2009) para 313.



Having considered and weighed all the arguments which the parties have presented to the Tribunal in respect of this issue, in particular the evidence and the authorities traversed in the present chapter, the Tribunal, in the exercise of its wide discretion, finds that, as a result of their material and significant wrongful act, the Claimants have contributed to the extent of 25% to the prejudice which they suffered when the Respondent issued the Caducidad Decree. The resulting apportionment of responsibility as between the Claimants and the Respondent, to wit 25% and 75%, is fair and reasonable in the circumstances of the present case.<sup>433</sup>

It is not clear why exactly the arbitral tribunal arrived at 25%, instead of 20%, 30%, or a different percentage. In this context, a principle of inclusion could at least persuade an investment tribunal to determine a more objective way and to consider elements that can allow for an evaluation of damages that also takes into account the economic reality of the host State<sup>434</sup>. For instance, the amounts of the budget of healthcare or education of a host country could be used as reference or limit in cases where, as in *Occidental*, arbitrators claim such wide discretion. In the end, wide discretion entails wide responsibility.

#### ***4.5 Insertion of the South American Principles***

Construction of a regional discourse depends on a minimal accord on legal principles among the various South American nations, specifically between the different legal sectors across the region (e.g. Human Rights, Constitutional, commercial lawyers). In addition, even if this discourse is consolidated, a second challenge remains: to properly insert these principles into the international investment law regime. This is a crucial step, because efforts to construct this

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<sup>433</sup> *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Award (5 October 2012) para 687

<sup>434</sup> In a later decision, a Committee partially annulled the award and reduced the amount to be paid to the investor as compensation. However, this reduction was not due to the reasons expressed in this section. See *Occidental Petroleum Corporation, Occidental Exploration and Production Company v The Republic of Ecuador*, ICSID Case No ARB/06/11, Decision On Annulment Of The Award (2 November 2015) para 586.

discourse only at the regional level might have a very reduced impact, if not properly overseen by investment adjudicators.

In this context, it is possible that the insertion of principles could proceed along two different paths that do not preclude each other, and which can even proceed in parallel: (i) Conventional or external means; and (ii) Non-conventional or systemic internal means (i.e. arbitral process litigation).

#### **4.5.1 Conventional or External Means**

This path refers to international consent from the various South American states to internalize principles, and it can manifest at two levels: the inter-state level with the signing of new treaties, and the private-state level where state consent is expressed through the use of contractual clauses.

Consent at the inter-state level refers to the creation of international norms that contain legal principles in relevant clauses. This does not imply the express need for a ‘Treaty of South American Principles for Investment’ — an idea that might be desirable but that could take years to materialize, like most regional efforts in Latin America. Instead, it refers to the insertion of principles from the South American Fundamental Cluster in the new international investment agreements that are being negotiated.

There are several signs that indicate that a new era of South American treaties is approaching and leaving behind the backlash against investment agreements that we witnessed in the early years of the 21st century. One sign of this trend is that states like Argentina, despite being the state most frequently sued by investors, have decided to celebrate the Qatar-Argentina BIT in 2016; this is Argentina’s first investment agreement in more than 15 years. Another sign of this trend comes from countries like Brazil, which launched its own category of investment agreements, the so-called Cooperation and Facilitation Investment Agreements (CFIA)<sup>435</sup>. These types of treaties differ from traditional investment agreements like BITs in several respects, but most remarkably for the absence of private-state mechanisms such as arbitration for solving disputes.

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<sup>435</sup> There are at least 6 CFIAAs that have been negotiated between Brazil and Chile, Colombia Mexico, Malawi, Mozambique and Angola. See <http://investmentpolicyhub.unctad.org/IIA>

It seems more likely that countries such as Argentina and Brazil which have chosen the various approaches described above, will reach agreements on the insertion of clauses with common principles (e.g. the principle of inclusion) than agreeing to a specific investment policy. For instance, the Argentina-Qatar BIT, incorporates a ‘right to regulate’ clause that gives states the leeway to achieve ‘legitimate policy objectives’ while the Brazilian CFIA also includes a section to this effect. Principles from the fundamental cluster, such as the inclusion principle, could help to better define the limits of investment agreements, and at the same time will establish a practice that may influence other countries in Latin America when they draw up new treaties.

However, it has to be acknowledged that this path involves external reforms to the regime and meaningful change could take years to materialize, while new treaties undergo a long process of negotiation and ratification by local parliaments. For instance, it is not known when the new Argentina-Qatar BIT and the Brazilian CFIA described in this section will be duly ratified, and therefore it could also be years (if ever) before they are applied in a concrete case of adjudication.

Within this path, another level of use is the private-state level, where a South American State could insert principles into contractual clauses. The use of this level also has its shortcomings, because a large proportion of investment arbitration arises from the breach of standards contained in international treaties, and in this sense the impact of contractual clauses will be limited to establishing the contractual responsibility of the state.

#### **4.5.2 Systemic Internal Means**

A challenge for the second path which uses insertion of principles is to internalize them during the process of adjudication, so they are visible to arbitrators in already existent disputes. Undoubtedly, this represents an elaborate enterprise, because it implies building concrete legal arguments based on the public law principles of the nation state involved in the dispute.

This path provides an option that could affect the outcome of future cases while avoiding the need to wait for an massive external reform of international investment agreements. As mentioned above, it could take years before new treaties provide a basis for investment disputes, and in the meantime, investment cases will

pile up in the region even in states that have not been sued in the past (e.g. Colombia).<sup>436</sup>

Internal means can be used to methodologically incorporate South American principles in the legal arguments prepared both by respondent states and investors in the same arbitral proceedings. The use of public law principles has been a core argument in new approaches to international investment law for the last ten years<sup>437</sup>, but a criticism of these approaches is that they could fall into ‘euro-centric comparativism’<sup>438</sup>. This criticism refers to the fact that an extraction of some of the ‘general’ principles of law applied in investment arbitration (e.g. legitimate expectations) are in fact the outcome of principles most widely used in certain jurisdictions.

In this sense, there might be a place in both an academic and practical sense for the regional legal discourse explained in this chapter, but only if we avoid two related pitfalls. First, the principles discourse needs to distance itself from those very critical stances that tend to reduce the legal world to ‘colonizer-colonized’ dichotomies<sup>439</sup>, missing the complexity of the normative developments that have taken place in recent years. Second, a closely related issue: avoiding the perception that the principles-discourse approach is either ‘pro-state’ or ‘pro investor’ since this polarization will immediately prevent its acceptance.

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<sup>436</sup> See the ICSID cases of Colombia against: América Móvil S.A.B (ARB(AF)/16/5); Glencore International A.G. and C.I. Prodeco S.A. (ARB/16/6); and Eco Oro Minerals Corp. (ARB/16/41)

<sup>437</sup> Most notably see Stephan W. Schill, *International Investment Law and Comparative Public Law* (Oxford Univ. Press 2010), Benedict; Schill Stephan Kingsbur, "Investor-State Arbitration as Governance: Fair and Equitable Treatment, Proportionality and the Emerging Global Administrative Law", (2009) *Institute of International Law and Justicem Working Paper 2009/6 Global Administrative Law Series*.

<sup>438</sup> In this regard, see the criticism in José E. Alvarez, "'Beware: Boundary Crossings' – a Critical Appraisal of Public Law Approaches to International Investment Law", (2016) 17 *The Journal of World Investment & Trade*. 220

<sup>439</sup> See an analysis of this dynamic in Balakrishnan Rajagopal, *International Law from Below Development, Social Movements and Third World Resistance* (Cambridge University Press, 2003).

With these caveats in mind, the use of South-American principles does not imply that they need be internalized only by respondent states, because they could also be invoked and internalized by investors in order to strengthen certain legal claims and arguments. As has been noted, the manifest arbitrariness or abuse of power of one state against an economic enterprise — whether it is national or foreign-owned — should be illegal. This is not only because the nature of this enterprise will have been determined by previous decisions taken by a group of arbitrators, who discussed the meaning of ambiguous words such as ‘fair’ and ‘equitable’, but also because it contravenes the fundamental public law of South American host states as specified both in their constitutions and in the Inter-American System of Human Rights.

In addition, inserting principles such as ‘inclusion’ in legal arguments, requires an analysis of proportionality. This implies that when an arbitral tribunal scrutinizes an action that is claimed to be ‘illegal’, it must do so using a public law methodology. In other words, proportionality analysis allows for the resolution of conflicts between principles that have the same normative hierarchy. Unlike constitutional adjudication where principles hold the same abstract value, the use of proportionality in investment conflicts implies that arbitrators have to resolve legal conflicts between standards of treatment contained in Investment Agreements, and the fundamental public law of the state that is used to justify a specific action.

Therefore, it has to be acknowledged that, on the one hand, insertion of a principles discourse using an analysis of proportionality runs the risk of conferring wider authority on arbitrators, but, on the other hand, it could prove an effective legal tool to mediate complex normative conflicts in the absence of the capacity to make a structural external reform in the short term.

## 5. Conclusion

Investment arbitrators no longer solve disputes, but instead exercise a unique type of public authority in the global legal space. It is true that disputes arising from foreign investments are not new in international law; in fact, they have occurred ever since the first treaties, such as the treaty of Munster, were signed in the current era. However, with the Abs-Shawcross Draft and the first BIT between Germany and Pakistan in 1959, a new regime emerged. And in 1991, after *AAPL vs. Sri Lanka*, the first arbitration case, was decided, this regime took a new turn. For the first time, a new type of public authority emerged from within the investment regime itself to address conflicts unlike those of previous centuries, which usually centered exclusively on matters arising from expropriations.

Traditionally, the nation-state enjoyed a monopoly on the use of force to back up its authority and enforce decisions. By contrast, today's investment arbitrators make decisions but lack the use of force to enforce them. However, they do possess a legal authority that can effectively restrain the actions of a state. This authority is manifested in two ways. First, it allows arbitrators to review the lawfulness of any act (or omission) of the public power by any of the branches of the state when a dispute arises in light of an IIA. If an evaluation establishes that an act has been unlawful, the investment arbitrator has the capacity to demand that a sum be paid in compensation. Second, this award can impact future cases brought forward by any party in the system, even in the absence of a formal system of precedents or connections between cases. It can be said that formally an investment tribunal cannot derogate a law or declare an administrative act void, but it can impose considerable costs on the state, which then limits that state's freedom to act.

That investment arbitrators can exercise this type of authority implies legal, sociological and moral challenges to their legitimacy. In traditional international commercial arbitration, the very fact that parties consent to submit their dispute to an impartial arbitrator is enough to legitimize his role. By contrast, in investment arbitration, the power granted to arbitrators is so far-reaching that its legitimization becomes more complex, since this power co-exists alongside the powers of the states and other international adjudicators.

The tensions generated by this type of authority operating outside the state has led to two types of response from South American societies. The first involves trying to restore the absolute authority of the state, in accordance with the postulates of the Calvo doctrine. However, it has been argued that this response is hard to implement, and can undermine other regional efforts such as the Inter-American System of Human Rights. The second scenario represents an effort at reform, in which, among other measures, development-friendly clauses are inserted into new treaties and other bodies are created for the adjudication of disputes. While most of these reforms will help to construct a more robust system, they require time to implement, and during this time dozens of new cases will be brought forward by investors. In this context, the present research explored a third scenario. Under this scenario, the legitimacy of international investment law is achieved from a systemic-internal perspective. This makes it possible to couple global and regional interests within the development of a legal discourse based on principles for investment.

It is possible to construct a discourse with these characteristics for South America in two steps. First, by creating a minimal accord on legal principles among the various South American nations, but most importantly among the different legal sectors that cut across the regions (e.g. Human Rights, Constitutional, and Commercial lawyers). The second step involves the insertion of these principles in the international investment law regime, using either: (i) Conventional methods, including both inter-state, (i.e. treaties) and private-state (i.e. contractual clauses); or (ii) Systemic methods (i.e. arbitral process litigation).

Previously, a framework to fulfil the first step—the development of a South American discursive legal approach to deal with international investment law—was provided by grouping three clusters of principles: (i) general investment principles, establishing due process and the right to access justice which serves to increase the acceptance of awards, (ii) intermediate principles, where an emerging concept of *seguridad jurídica* (legal certainty) could be further analysed, and (iii) fundamental legitimation principles, including the principle of transparency as the exercise of the rights of freedom of expression and access to information, and a

principle of inclusion, that can be used by the same arbitrators to assess the proportionality of any state majeure.

The proposed framework does not by any means claim to solve all of the legitimacy problems or deficits that have been attributed to international investment arbitration, since there are several other issues that can be handled using the same systemic internal perspective, such as the codes of conduct for arbitrators. Instead, it seeks to a) challenge the way that South American nations usually think about these issues and b) set the path for inter-systemic options of reform.

In this quest, it may be useful to reference Carlos Calvo: not his fundamentals of 1867, but rather his approach to developing a strong conceptual framework that could be understood by everyone. That is the function that principles should have; they must allow non-legal experts in society to engage in meaningful public debate. Finally, this regional principles approach to investment can work as a legal bridge between the logic internal to international investment law regime and the social and political reality faced by South America populations, which is still characterized by a considerable inequality gap.

In the current context of global uncertainty with debates on ‘parochialism’ vs. ‘universalism’, ‘fragmentation’ vs. ‘pluralism’ and where academic lines between legal terms such as ‘public’ and ‘private’ are becoming blurred, there is a need for South American societies—in states that have neither economic, political nor military power at their disposal—to more closely embrace rather than to antagonize the law. This is the core message this in-depth analysis seeks to communicate.



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